REPORT OF THE INTERMINISTERIAL TASK FORCE ON AGRICULTURAL FINANCE

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Ministry of
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Legislative Buildings
Queen's Park
Toronto, Ontario

May 20, 1986

TO: Honourable Jack Riddell
Minister of Agriculture and Food

Honourable Robert F. Nixon
Treasurer of Ontario and
and Minister of Economics

I am pleased to submit for your consideration the report of the Interministerial Task Force on Agricultural Finance.

I wish to acknowledge the diligent efforts and the high degree of co-operation among the members of the Task Force. Every member made valuable contributions in the preparation of this report. I would also like to acknowledge the many individuals and groups which submitted briefs to the Task Force. Without their contributions, this report would not have been possible.

The members of the Task Force are:

Walter Boyd
Economics and Policy Coordination
Ministry of Agriculture and Food

David Brand
Office of the Treasury
Ministry of Treasury and Economics

Carol Layton
Office of the Budget
Ministry of Treasury and Economics

Stephanie St. Pierre
Office of Economic Policy
Ministry of Treasury and Economics

Marius Schuetz
Farm Assistance Programs Branch
Ministry of Agriculture and Food

Ralph Winslade
Agricultural Representatives
Branch
Ministry of Agriculture and Food

Respectfully submitted,

Nancy Bardecki

Nancy Bardecki
Chairman
Interministerial Task Force on Agricultural Finance

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EXECUTIVE SUMMARY

INTRODUCTION

Agriculture in Ontario, Canada and the rest of the world is undergoing a significant structural adjustment. While adjustment is necessary to ensure a healthy, competitive industry in the years ahead, it is currently causing considerable economic and social hardship.

As a short-term and immediate response to farm financial pressures, the Ontario Minister of Agriculture and Food, the Honourable Jack Riddell, and the Treasurer of Ontario and Minister of Economics, the Honourable Robert F. Nixon, announced the Ontario Family Farm Interest Rate Reduction (OFFIRR) Program on August 8, 1985. At the same time, the Ministers established the Interministerial Task Force on Agricultural Finance to develop a longer-term approach to the farm finance issue.

The Task Force mandate is defined as follows.

1. Examine the financial and economic environment for agriculture, with particular reference to:
    - o beginning farmers
    - o exiting farmers
    - o farmers in financial difficulty
    - o farmers' adoption of technology.
2. Assess the financial needs of the agriculture industry.
3. Assess existing financial assistance programs.
4. Assess the need for new government initiatives.

The Task Force invited submissions from all participants in the agricultural sector. The response from groups and individuals assisted in identifying issues and problems, and in formulating recommendations.

PROBLEMS IN AGRICULTURAL FINANCE

The Task Force identified five major problem areas in the agricultural sector.

1. <u>Cost and Availability of Credit</u>
    - . Real interest rates are high and likely to remain so for some years.

- Lending instruments which match the term of a loan with the life of an asset are not always available.

- Lenders' security requirements mean that some farmers find availability of credit to be limited, even where they are able to adequately service debt.

- When farmers retire, their financial capital usually leaves the agricultural sector.

2. High Capital Requirements for Agriculture

- Cash inflow from farming operations is generally insufficient to service the full capital costs of farming assets. Accordingly, a large proportion of equity is usually necessary to prevent debt servicing problems.

- The tenure structure (primarily owner/operator) of agriculture creates the need to refinance a farm every time there is a change of operator.

3. Commodity Prices and Incomes

- The variability of gross income due to both yields and prices results in fluctuating debt servicing capacity and net income.

- Subsidy programs undertaken by other jurisdictions mean that Ontario farmers are not on an equal footing with their competitors.

4. Management

- Financial management skills of all participants in the farm financial market did not keep pace with the rapid growth of capital and debt over the 1970's.

- There is a wide variability in agricultural productivity; not all farmers are financially able or knowledgeable enough to adopt the most economic production techniques.

5. Other

- Social and employment related services are typically urban-oriented and not easily accessible or suited to the rural community.

- Farmers are unable to adjust output quickly to meet changing market conditions.

- Some farmers have debt loads which are difficult and in some cases impossible to manage at current income levels.

FINANCIAL CHARACTERISTICS OF ONTARIO FARMERS

To assess the scope and level of farm financial problems, and to identify the groups to which programs can most effectively be targeted, farms have been divided into five categories on the basis of equity and net income characteristics.

1. Insolvent.

2. Solvent, negative cash flow.

3. Solvent, positive cash flow, full depreciation costs not covered.

4. Solvent, positive cash flow, full depreciation costs covered, profits insufficient to fund new technology.

5. Solvent, positive cash flow, full depreciation costs covered, profits sufficient to fund new technology.

CONCLUSIONS AND RECOMMENDATIONS

Agriculture is undergoing significant structural adjustments. Stagnating or falling commodity prices, combined with rising costs, are reducing profitability of the industry. The resulting reduction in asset values is causing a further deterioration in farmers' wealth. Nonetheless, it must be recognized that the spread between farm returns and expenses is not strictly a result of global economic factors, but is also strongly influenced by production efficiency and marketing management.

Governments can mitigate the most harmful effects of the transition to new economic realities, but cannot reverse trends in the global economy. If Ontario agriculture is to be competitive in world markets in the years ahead, governments should not interfere unduly with market processes. These processes are reducing the costs of production and contributing to improved aggregate levels of productivity and marketing efficiency, both through the exit of less efficient farmers and through improved business practices of those who remain. Still, part of government's role is to ensure that the industry is not so badly weakened by short-term adverse economic conditions that it is unable to take advantage of emerging opportunities.

The above premises have been the focus of the Task Force in its development of the recommendations.

The Task Force directed its attention to a wide range of recommendations aimed at beginning farmers, existing operations (including those in financial difficulty) and exiting farmers. In addition to recommending specific initiatives for immediate implementation, the Task Force also recommends items to be implemented in the medium term and suggests areas where further study would be valuable.

For Immediate Implementation

Beginning Farmers

1. Amend the Beginning Farmer Assistance Program (BFAP) as follows.

   - Increase the benefit period for individual participants from five years to nine years, gradually reducing the benefits in each of years six through nine.

   - Increase the net worth criterion by $100,000. Full benefits would be available to those with a net worth of up to $200,000, and partial benefits would be available to those with a net worth of between $200,000 and $300,000.

2. Allow participants in the Beginning Farmer Assistance Program to apply for benefits under an extended Ontario Family Farm Interest Rate Reduction Program. The amount of loan eligible for benefits under OFFIRR would be reduced by the amount of loan covered under BFAP.

Ongoing Operations

3. Expand and enhance the Ontario Family Farm Interest Rate Reduction Program as follows.

   - Provide full benefits for 1986, followed by a phaseout providing 70% of benefits for 1987 and 40% of benefits for 1988.

   - Increase the net worth criterion by $200,000. Full benefits would be available to those with a net worth of up to $500,000 and partial benefits to those with a net worth between $500,000 and $700,000.

4. Expand and enhance the Farm Operating Credit Assistance Program (FOCAP) as follows.

   - Reduce the effective interest rate payable by the farmer to 8% from 9.75%, subject to a five percentage-point cap.

   - Increase the maximum allowable equity to 75% from 60%.

   - Extend program eligibility to currently excluded agricultural commodities (eg. sod, flowers, fur).

- Discontinue coverage of floating-rate term loans and provide benefits only on operating loans, beginning in 1987.

5. Provide a continued educational thrust across Ontario to ensure that farm lenders, advisors and borrowers have the opportunity to learn and develop appropriate financial skills at agricultural colleges and through seminars and courses. Undertake a continuous review of financial management tools to ensure that the most appropriate tools are available.

6. Encourage the federal government to introduce income support measures, possibly through enhanced stabilization, to mitigate the short-term adverse impact of the 1985 U.S. Food Security Act.

Exiting farmers

7.(a) Continue the Re-establishment Assistance portion of the Farmers in Transition (FIT) Program only until the Canadian Rural Transition Program, announced in the February 26, 1986 federal budget, is in place. Assuming that this federal program provides similar or better services than those provided through Ontario's Re-establishment Assistance Program, the Ontario program should be wound down.

(b) Encourage the federal government to provide a choice of options under its Rural Transition Program.

For farmers of retirement age:

- An interest-free loan secured by a mortgage on a retirement dwelling.

- A six-month allowance.

For other farmers:

- A relocation grant and on-the-job training.

- Living allowance during institutional education.

- Cash transition grant and wage subsidy.

<u>For Implementation in the Medium Term</u>

8. The Province should undertake the following initiatives.

(a) Development of a database on the financial conditions of farmers in Ontario for economic and financial analysis for policy development.

(b) At least six months prior to BFAP's expiry, consideration of a new program to succeed BFAP. The new program should encourage the formation of equity, as opposed to subsidization of debt, and accommodate leases with option to purchase as an option eligible for financial assistance.

(c) At least six months prior to FOCAP's expiry, completion of a program review to determine whether it is meeting the needs of the client group at that time, and whether it should be continued, amended or eliminated.

(d) Completion of a similar review of the Helpline and Farm Family Advisor components of FIT.

(e) Enhancement of extension efforts to encourage share-farming and leasing arrangements for beginning and expanding farmers, including the development of standard forms of leasing contracts.

(f) Assessment of the Trust Companies Act to eliminate the impediments to trust companies entering the farm credit market.

9. Encourage the federal government to undertake the following.

(a) Provide guarantees of private mortgages through the Farm Credit Corporation.

(b) Consider expanding the Farm Credit Corporation mandate to include lending for machinery, equipment and other intermediate-term assets.

(c) Amend the Farm Improvement Loans Act to include guarantees on fixed-rate term loans.

Ideas for Further Study

. The role of part-time and combined-income operators in the farm sector and rural communities.

. The future role of credit unions in the farm credit market.

. Alternative government initiatives to facilitate the introduction of the following debt instruments by commercial lenders and the Farm Credit Corporation:

- interest rate insurance;
- accrued interest mortgages;
- variable amortization mortgages;
- graduated payment mortgages;
- split risk mortgages (already taken by FCC).

. Consider eliminating the use of guarantees under the Ontario Young Farmer Credit Program as security for loans for marketing quota.

- The impact of federal and provincial legislation on the security of farm loans (Bank Act, Section 178; Personal Property Security Act).
- The objectives of the Farm Tax Reduction Program and an assessment of its effectiveness in achieving these goals given the large expenditure associated with the program.
- The feasibility of introducing a pension fund and extending unemployment insurance benefits to small business, including farmers.
- The feasibility of a Registered Farm Investment Fund.
- A review of tax legislation as it relates to agriculture.
- The potential for implementation of a joint interest subsidy program by lenders and government.

1. INTRODUCTION

Agriculture in Ontario is undergoing significant structural adjustment as the result of profound changes that took place in the world economy during the late 1970's and early 1980's. This is causing serious hardship for a large number of farmers, particularly those with high debt loads.

Farmers have for many years faced the live-poor, die-rich phenomenon related to relatively low operating returns and high capital investments. The situation was exacerbated by escalating land prices during the 1970's, which were caused by competing non-agricultural demand, and expectations for increasing demand and rising prices for agricultural outputs. In addition, the expectations of capital gains associated with these developments led to further increases in farmland prices, pushing the cost of land even further above its income generating capacity.

When these expectations were not met, many farmers with high debt loads found themselves unable to service debt with farm income. Also, inflation started to abate and farm land values dropped contributing further to the recession that characterizes agriculture in the 1980's.

In his July 11, 1985, Statement to the Legislative Assembly, the Treasurer of Ontario and Minister of Economics, the Honourable Robert F. Nixon, stated that:

> "There remain severe problems in the agriculture sector that must be addressed,"

and that:

> ". . . ensuring the future viability of the agricultural sector is a priority of this government."

On August 8, 1985, the Minister of Agriculture and Food, the Honourable Jack Riddell, and the Treasurer announced the Ontario Family Farm Interest Rate Reduction (OFFIRR) Program as a short-term and immediate response to financial pressures in the farm sector. At the same time, the Ministers established the Interministerial Task Force on Agricultural Finance to develop a longer-term approach to the farm finance issue. The mandate of the Task Force was defined as follows:

1. To determine the relationship between current patterns of agricultural financing (including the financial environment created by private lenders, federal agencies, etc.) and the ability of the industry to adjust to the continually changing economic environment, with particular reference to:

(a) the entry into the industry by new farmers;
(b) the exit from the industry by retiring farmers;
(c) farmers' ability to take advantage of new technology;
(d) farmers currently in financial difficulty.

2. To determine the financing needs of the agricultural industry in meeting its objective of anticipating market developments and in adjusting to those developments without financial assistance from outside the industry.

3. To determine the effectiveness of current financial assistance programs and services in helping the agricultural sector achieve its goal.

4. To determine the need for new government initiatives to assist the agricultural community to meet its objectives, with special reference to financial arrangements.

The Task Force was established in response to a number of factors which will continue to dictate the direction of the agricultural economy. Governments can exert influence to mitigate, to some degree, the most adverse impact of these factors. They must also help to ensure that the basic structure of the farm sector remains intact and that the sector is ready to take advantage of emerging opportunities.

The Task Force has examined the current economic and credit environment, and identified the special financing needs and related problems facing the agricultural industry. A clear definition of the issues is essential for the development of effective proposals.

The problems in agricultural finance are outlined in Section II. The economic environment in which the agricultural sector operates is discussed in Section III and in Section IV the financial characteristics of Ontario farms are discussed. Section V presents a description of the major uses and sources of credit, and the factors underlying the supply and demand for credit are the topic of Section VI. An assessment of existing programs is presented in Section VII. In Section VIII the major points of the proposals considered by the Task Force are discussed. Finally, in Section IX, the Task Force's conclusions and recommendations are presented.

II. PROBLEMS IN AGRICULTURAL FINANCE

The sometimes volatile economic environment, combined with the unique structural features of the industry, have resulted in a number of problems in agricultural finance. These problems, many of which have been identified in submissions received by the Task Force (see Appendix A for Summary of Submissions), relate to the cost and availability of credit, capital requirements for farming assets, commodity markets, and farm incomes and management skills.

These problems have had a significant impact on the productivity, profitability and competitiveness of the agricultural industry and will continue to do so in the future. From an individual's point of view, these problems affect: the ability and willingness to begin farming; the ability and willingness to continue investing in farming; income levels and quality of life. Some highly leveraged and/or less effectively managed enterprises are unable to continue farming.

The following is a detailed listing of the problems that affect agriculture. While the problems have been placed into distinct categories it should be noted that some issues do overlap.

Cost and Availability of Credit

- Real interest rates are high by historical standards and likely to remain burdensome for some years.

- Lending instruments which match the term of a loan with the life of an asset are not always available. This is particularly true with regard to the purchase of machinery, equipment and land; in such cases five years generally is the longest fixed-rate term available from chartered banks and other private sources of credit. Thus, financial planning is difficult and a rational economic decision can quickly become impracticable if the cost of credit rises. This situation is worsened by interest rate instability.

- Lenders' security requirements mean that some farmers find availability of credit to be limited, even where the farmer appears to be capable of servicing debt. This situation is particularly applicable to beginning farmers and farmers with low equity due to asset depreciation and operating losses.

- When farmers retire, their capital tends to leave the agricultural sector. Because of the desire for security of retirement assets, vendor take-back mortgages are not readily offered.

High Capital Requirements for Agriculture

- Cash inflow from farming operations is generally insufficient to service the full capital costs of farming assets. Because land has historically appreciated over time, people tend to bid more for land than its productive value. This was evident throughout the 1970's and very early 1980's, when inflationary expectations caused land prices to rise faster than expected productivity increases. Accordingly, a large proportion of equity is usually necessary to prevent debt servicing problems.

- It is often assumed that family farms cannot exist unless the operator has outright ownership of land, buildings and other assets. Leasehold and other rental forms of asset control are unusual in Ontario, even though rental costs can be substantially lower than principal and interest payments. This tenure structure creates the need to refinance a farm each time there is a change of operator. Current statistics suggest that the turnover of a farm occurs on average once every 15 years.

Commodity Prices and Incomes

- The variability in gross income due to yields and prices results in variations in debt servicing capacity and net income.

- Commodity prices have been volatile, but in real terms prices for most commodities outside supply managed sectors are lower today than they were in 1974. The 1985 United States Food Security Act is expected to result in a continuation of this trend. Current world commodity supplies are in excess of demand and further price declines can be expected.

- Ontario farmers must compete on international markets that are characterized by large and increasing inventories, often created by production from farmers from other jurisdictions who receive significant subsidies.

- Subsidy programs undertaken by other provinces mean that Ontario farmers are not on an equal financial footing with their competitors elsewhere in Canada. Ontario has one of the lowest federal and provincial assistance expenditures, per farm and per dollar of agricultural output, of any province.

Management

- Financial and production management skills of farmers did not keep pace with the rapid growth of capital and debt during the 1970's.

- Professional skills in the accounting, legal, consulting and banking businesses do not always meet the needs of the farm industry.

- There is wide variability in productivity in agriculture and not all farmers are financially able or knowledgeable enough to adopt the most economic production techniques.

Other

- Economic adjustment is taking place by way of a decline of farm asset values, resulting in some displacement of highly leveraged farmers and consequently in social disruption. Social and employment related services are currently urban-oriented and not easily accessible to or suited for the rural community.

- The biological time lag means that farmers cannot quickly adjust to the rapidly changing marketplace.

- Some farmers have debt loads which are difficult and in some cases impossible to manage at current income levels.

III. ECONOMIC ENVIRONMENT

1. General Economic Situation and Outlook

Canadian agriculture is a large, capital-intensive industry, operating in national and international capital markets in competition with other users and suppliers of capital. Accordingly, factors which are exogenous to agriculture have a significant influence on the price, terms and availability of agricultural credit.

The general rate of inflation (change in Consumer Price Index), the prime rate, and the real (after-inflation) rate of interest from 1961 to the present are shown in Appendix B, Table I. After a decade of relative stability throughout the 1960's, interest rates in both real and nominal terms became increasingly volatile in the 1970's and 1980's. From 1970 to 1975, the real cost of credit, as expressed by the real interest rate, declined from about 5% to -1.4%, inducing an accelerated growth in the use of farm credit (See Appendix B, Table IV.) Between 1975 and 1984, the real cost of credit increased to the unprecedented level of 7.7%, causing substantial hardship among farmers, reduced investments in farm capital and a levelling of the trend in farm credit outstanding.

Short-term interest rates are expected to continue to decline during 1986 as the Bank of Canada gradually reduces Canada-U.S. rate spreads. However, real interest rates remain high by historical standards. As a business that uses substantial amounts of credit, agriculture has been, and will continue to be, affected significantly by the still-high real interest rates.

2. The Economic Situation and Outlook in the Agricultural Sector

The charts contained in Appendix B illustrate trends in selected farm financial data from 1970 to 1985. They illustrate farm income in Ontario and Canada and how net income has been affected by input costs and commodity prices throughout the period.

Farm Inputs

The costs of farm inputs (supplies, materials, labour, credit, etc.) rose steeply through the last half of the 1970's, in line with increased inflation and the expansion in demand that took place within agriculture at that time. (See Appendix B, Chart I.) These increased farm costs put pressure on income and, in turn, increased the demand for operating credit. Farm input costs increased at much more moderate levels from 1981 to 1985, as inflation levelled off.

Farm Commodities

The price movements in beef and pork are shown in Appendix B, Chart 2. Beef and hog production accounted for 32% of Ontario's farm cash receipts in 1985 (total farm cash receipts in 1985 totalled $5.1 billion). Ontario's beef prices have been flat since 1979 mainly because of lower consumer income, changing lifestyles, and increasing competition from alternative products. Hog prices in Ontario have declined since 1982. At $67/cwt. in 1985, Ontario's hog prices were lower than in 1981. Increased production, lower consumption of red meat and increased competition from alternative products are the main factors contributing to lower hog prices. Some improvement in prices is expected in 1986 as supply declines by about 4% from 1985 levels.

Soybean and grain production accounted for 15% of Ontario's farm cash receipts in 1985. Both soybean and grain prices follow the price trends established in the U.S. market (See Appendix B, Chart 3.) Soybean prices in both the U.S. and Canada are currently declining because of excess supply.

Supply-managed commodities (dairy, poultry, tobacco and eggs) represented 30% of Ontario's farm cash receipts in 1985, compared with 33% in 1984. The prices of supply-managed commodities have risen consistently throughout the period studied and generally kept pace with the cost of inputs. Despite the fact that current Ontario chicken prices are the same as those in 1983, the overall trend for the 15-year period studied has been upward. (See Appendix B, Chart 4). Milk prices in Ontario have also risen steadily throughout the period. Milk price increases have eased off from the growth of 1979 to 1981. Fluid milk prices, currently at $52.51/hectoliter have not increased since December 1984, but industrial milk increased $1.09/hectoliter to $40.98 in August 1985. (See Appendix B, Chart 5.)

Farm Income

The charts in Appendix B also illustrate the current cost-price squeeze that farmers are experiencing. Since 1981, input costs have been increasing and prices received for many commodities have fallen. Consequently, farmers are caught in a cost-price squeeze that erodes their income unless major changes in husbandry practices result in compensatory increases in productivity. This has brought about an increased demand for credit to cover losses which has in turn compounded debt servicing problems.

On a 1971 inflation-adjusted basis, realized net farm income in Canada has been declining since 1974 (See Appendix B, Chart 6.) The 1985 figure of $1.2 billion is slightly lower than the real net income Canadian farmers earned in 1970. In Ontario, inflation-adjusted real net income per capita has remained relatively stable from 1970 to 1985. But like that of their counterparts elsewhere in Canada, Ontario farmers' real net income in 1985 ($347 million) was lower than the income in 1970 ($369 million). As a consequence, many farmers feel that agriculture has lost ground in recent years, relative to the rest of the economy. It should be noted that the number of farms has declined over this period, accordingly this income is spread among fewer farm families.

Outlook

During the last decade, farmers have witnessed a major change in their financial environment. Farmers in the 1970's experienced healthy incomes and large increases in wealth from rising land values. Expectations for future profitability in farming were high. The onset of the 1980's, however, substantially weakened this prosperous environment and many farmers now find themselves faced with declining incomes from falling commodity prices, rising costs and declining equity resulting from falling property values.

The U.S. Farm Bill (Food Security Act of 1985) became law on December 23, 1985. The thrust of this bill is a major shift in U.S. federal policy on basic farm commodities. Price-support floors will be lowered in an attempt to make U.S. farm commodities more competitive in world markets. At the same time, income subsidies to U.S. farmers will be provided.

The combination of excess world stocks, a major shift in U.S. agricultural policy and lower loan rates in the U.S. could mean continued low grain prices and several more years of tight financial conditions for grain producers.

Depressed grain prices will likely encourage increased hog production, with the result that prices for pork will remain low. Large beef herd reductions during the past several years indicate that some improvement in beef prices may occur in the next few years. This will be tempered by two factors: the demand for beef has fallen in recent years; and, increased pork and poultry production, as a result of lower grain prices, will provide greater competition for beef. Consequently, beef prices may only improve slightly.

IV. FINANCIAL CHARACTERISTICS OF FARM BUSINESSES

In order to analyze the financial problems in Ontario agriculture, it is important to understand the financial circumstances of various groups within the sector. Variations in farm size, sales, equity and debt levels all have a bearing on the ability of the farm operation to withstand fluctuating markets and economic conditions.

A number of farm businesses, including some with good production management, have accumulated debt loads that cannot be serviced at market rates of interest. There are a number of factors that contribute to this situation, including high interest rates, capital expenditures and repeated loss carryovers. In addition, some farm businesses are in difficulty because of financial or production mismanagement. Yet the majority of farmers are able to realize a modest profit.

For the purposes of this report, farms have been divided into five groups on the basis of equity and net income characteristics.

Group 1: Liabilities exceed assets. Bankruptcy is imminent.

Group 2: Assets exceed liabilities, but cash inflow is insufficient to cover debt payments and family living costs. Equity is eroding rapidly.

Group 3: Assets exceed liabilities. Cash receipts cover cash expenses and family living costs, but do not allow for full replacement of machinery and equipment.

Group 4: Assets exceed liabilities. Obsolete machinery and equipment can be replaced readily and a comfortable living is provided, but the farm does not provide sufficient profits for adoption of new technology.

Group 5: Assets exceed liabilities. Cash receipts cover cash expenses, a comfortable living and replacement costs. Funds for the adoption of new technology are also available.

Under the Ontario Family Farm Interest Rate Reduction Program, a database is being developed to further contribute to the availability of statistics on the financial characteristics of farmers.

V. USES AND SOURCES OF CREDIT

1. Uses of Farm Credit

During the 1970's, under the influence of low interest rates, high profit expectations and increasing land values, most farm transfers, expansions and technological innovations were financed with debt. As a result, the use of farm credit is heavier among those who recently entered the industry or those who undertook major investments during this period.

Farm credit has not only been used for acquiring assets, but also for covering shortfalls in farm operating income. This practice has escalated since the early 1980's, and despite a decrease in the value of farm assets, the use of credit has increased. (See Appendix B, Tables II and IV.)

When farm credit is used to finance assets, the investment falls into three categories: current, intermediate and fixed assets. More than 75% of the assets in the farm sector are fixed, with the remainder split almost evenly between intermediate and short term. Liabilities of the farm-sector, however, follow a different pattern with long-term debt representing 21%, intermediate-term - 27% and short-term credit - 52% of total outstanding credit (see Appendix B, Table V).

2. Sources of Farm Credit

Farmers have traditionally obtained credit from financial institutions, trade suppliers and private sources. In 1959, the federal government became the fourth major supplier when it instituted the Farm Credit Corporation (FCC) through the Farm Credit Act. The following is a brief description of credit sources for farmers.

The Chartered Banks

The chartered banks are the most important source of farm credit in Ontario, supplying 47% of all farm credit used in the Province (see Appendix B, Table IV). Historically, they supplied mostly short-term credit based on the traditional note system. A change began in the late 1930's when other financial institutions, such as insurance companies, withdrew from their roles as major suppliers of mortgage-secured, long-term farm credit. The chartered banks became major suppliers of medium-term loans in the late 1960's, while long-term credit from the banks started to flow in 1978. Currently, the farm loan portfolio of the chartered banks consists of short, medium and long-term credit in approximately equal proportions. In the short and medium-term markets, banks are the most important suppliers and in the long-term credit market they are second only to FCC.

During the 1970's, the banks developed a reputation for offering farm loan services that were generally considered more attractive and lower priced than services for other small and medium-sized businesses. Loans were largely based on market values of farming assets rather than on values relating to agricultural use. This became particularly prevalent when FCC adopted the same approach, even though in the late 1970's and early 1980's farmland changed hands at values far in excess of their agricultural use value. Yet the farm sector criticized the banks for the lack of bank credit and the reluctance of banks to lend to highly leveraged farmers.

Subsequently in the eighties, under the influence of depressed commodity markets and high interest rates, land values started falling. Chartered banks became reluctant participants in farm operations where operating losses were financed by debt consolidation.

There is now evidence that chartered banks are reassessing their activities in the farm credit market. Loan proposals are evaluated more carefully and credit standards are being tightened, resulting in reduced credit for the farm sector. In particular, beginning farmers and those expanding their operations may be affected by stricter credit requirements. Farmers in financial difficulty are finding the changing policies a barrier to continued farming. This has given rise to government programs to ensure that financing is available to viable farm operations.

Farm Credit Corporation (FCC)

For the first 20 years after its establishment in 1959, FCC was virtually the only institutional supplier of long-term credit secured by mortgages. In 1978, the chartered banks entered this segment of the farm credit market. Currently, FCC supplies 45% of long-term farm credit, or about 25% of all credit used in the farm sector in Ontario. FCC's role in the farm credit market is unique because it is an instrument of government policy concerned with both economic and broader agricultural objectives.

Trade Credit

Equipment suppliers are a significant source of farm credit. It is estimated by the Task Force that at least 50% of all farm equipment sold through dealers is financed by credit from the equipment manufacturers at terms that range up to four years. The supply of equipment credit has not been a problem as equipment companies have managed to keep loan write-offs low through high lending standards and security. The supply of trade credit for farm material purchases is not nearly as stable. Because of the nature of the industry, the suppliers of fertilizers, chemicals, feed and seed often cannot avoid providing credit for at least 30 to 60 days. However, if a farmer becomes insolvent in that period, most dealers are unsecured creditors, taking a subordinate position to chartered banks. This imposes strict credit limitations on suppliers because it is often difficult to determine the financial state of farm customers and the security position of other suppliers and lending institutions in the event of insolvency.

The Province

Ontario farmers benefit in several ways from loans and loan guarantees offered by the Province of Ontario through a number of programs. The most important of these are the Ontario Tile Drainage Act ($144 million in loans outstanding), the Junior Farmer Establishment Loan Corporation ($38 million outstanding), the Ontario Farm Adjustment Assistance Program and Farm Operating Credit Assistance Program ($55 million guaranteed) and the Ontario Young Farmer Credit Program ($3.4 million guaranteed). Ontario also provides interest rate relief through the Beginning Farmer Assistance Program, the Ontario Family Farm Interest Rate Reduction Program and the Farm Operating Credit Assistance Program.

Other Sources

Private lenders play a significant part in farm credit by providing financing arrangements when they sell property. Because private lenders cannot spread risk the way institutional lenders can, private lending is mostly limited to family transactions.

Credit unions do not play a major province-wide role, but are active in some regions. There is limited activity in the farm credit market by the trust companies. Finance companies play a limited role in providing farm credit to highly leveraged farmers. Insurance companies have all but disappeared from the farm credit market.

VI. FACTORS AFFECTING THE SUPPLY OF AND DEMAND FOR FARM CREDIT

The supply of and demand for farm credit are influenced by many factors. These factors can be divided into two major areas: economic and institutional. Both have an impact on current farm financing patterns.

1. Economic Factors

The major economic factors affecting the farm credit markets are interest rates, return on assets in farm production, and farm incomes and debt.

Interest Rates

Interest rates fluctuated greatly from 1970 to 1985. As can be seen in Appendix B, Table I, the real rate (the nominal rate adjusted for inflation) decreased from 4.7% in 1961 to -1.4% in 1975 and then rose to 7.7% in 1984. The real cost of credit was negative in the mid-1970's, but later increased substantially. Consequently, annual growth in the use of farm credit dropped to about 3.5% in 1984 as farmers reduced investments.

Interest rates and the risk associated with farm lending influence credit availability. Lenders typically consider the return on farm loans, the cost of administration and the risk of loan losses. Farmers look at the real cost of credit and the return on assets in their operation to determine whether investments should be made and if so, whether they should be financed by debt or equity.

For lenders to provide credit to the farm sector, loan revenues must be at least as attractive in agriculture as elsewhere. Farmers cannot effectively influence the credit markets, so they must simply pay the going rate. As a result, credit has been available to farmers in unlimited supply as long as they were able to pay the market rate and as long as the lender's risk was not higher than in other sectors of the economy.

During the 1970's, the risk of losses by lenders from their agricultural loan portfolios was virtually nonexistent. Even in cases where farmers suffered significant operating losses, lenders were able to protect their interests by increasing security as inflation pushed farmland values higher. In addition, the cost of administering farm loans was relatively low and farm lending was generally considered a profitable business. Competition, especially among the chartered banks, was effective in keeping rates on farm loans below those for other small and medium-sized businesses.

In the 1980's, however, this situation has reversed as farm operating profits have declined and farm property values have started to fall. Heavily leveraged farmers have started to become less profitable and many have started to suffer significant operating losses. Farmland has ceased to provide the additional security required to obtain further credit to finance operating losses. This is particularly so for low equity farmers. This has invoked various new government initiatives to ease the adjustment of the farm sector to the changed economic environment. An example is the Farm Operating Credit Assistance Program which provides assistance by way of guarantees on operating loans to potentially viable farmers.

In addition, the cost of administration and supervision of farm loans by the chartered banks has increased substantially. The banks have begun to pay more attention to cash flow and the general viability of their clients. The process of loan recovery where farmers have defaulted has also become cumbersome. Bankers have found that previously agreed upon arrangements are being violated and that some farmers are undertaking fraudulent action. The banks are reacting by making the availability of credit more selective, increasing the margin over prime and by demanding fees for services previously rendered to farm clients without charge. Further service fees may be forthcoming. In essence, many will pay the price for the actions of a few.

Return on Assets in Farm Production

The extent of credit demanded by the farm sector is determined by the level of new farm investments and the relationship between the interest rate and the return on assets. In principle, as long as the return on investment is higher than the interest rate, it pays to borrow to finance an investment. When the interest rate on farm loans is higher than the return on assets the investment may still be profitable when financed by equity as long as the rate of interest on bank deposits or other alternatives is lower than the return on assets.

The return on assets is determined by the sum of operating income and asset value appreciation. During the early seventies, net farm operating incomes were modest but later in the seventies and in the early eighties, the contribution to the return on assets by land value appreciation was substantial. Aggregate asset values increased from $6.9 billion in 1971 to $31.3 billion in 1981. Of this, 75% was strictly on account of inflation and only 25% on account of physical additions to the capital stock. This resulted in generally attractive overall farm incomes. However, the appreciation of land values was not so much based on productivity increases as it was on the expectation of future profitability in farming and the perceived value of farmland as a hedge against inflation.

Therefore, through the capitalization of expected future gains into current market values, there developed a large speculative element in land values which eventually increased well in excess of current agricultural use values. Subsequently, expectations of farming profitability changed dramatically as commodity markets became depressed and as inflation came under control, farmland lost some of its value as an inflation hedge. This caused the market for farm real estate to reverse in direction. Whereas previously inflationary changes added substantially to the return on assets in farming, now the declining asset values exerted a negative influence on the total return on assets. This caused considerable financial difficulty for those who invested heavily in farmland during the late seventies and early eighties. As market values come more in line with agricultural use values there will again be attractive opportunities in the agricultural industry as it regains its viability and as operating returns become adequate to service the capital cost of farm assets.

Farm Incomes and Debt

Farm incomes are strongly related to debt. During the period 1975 to 1984, interest charges were between 7 per cent and 14 per cent of aggregate realized gross income in Ontario and between 25 per cent and 44 per cent of aggregate realized net farm income before interest charges. During the same period, the debt-to-asset ratio in the farm sector in Ontario fluctuated between 14.3 per cent and 18.4 per cent. As the above figures represent averages, it is clear that for higher leveraged farmers the cost of credit was a higher proportion of farm income and many therefore suffered operating losses during this period. See Appendix B, Table II and Table VII.

This in turn led to an increase in the demand for credit as operating losses were financed by way of debt as long as available security was sufficient to cover the margin required by lenders. Until 1982, this was generally possible as appreciation of farm values offset operating losses.

Since 1982, the farm real estate market has declined and many farmers who invested in agriculture at that time are now confronted with a significantly reduced net worth. This has sharply reduced lenders' willingness to finance operating losses and farmers are now finding it increasingly difficult to obtain credit to continue farm operations. In view of the above it may be concluded that while the original causes for high debt loads often differ by farm and commodity group, a common characteristic among farmers in financial difficulty is high debt loads.

2. Institutional Factors

Institutional factors affecting farm credit supply and demand are: the federal government's direct role in credit provision, the tax system, supply management, ownership structure, and legislation affecting suppliers of farm credit. These factors are discussed in detail below.

The Federal Government as a Supplier of Credit

The federal government, through the Farm Credit Corporation (FCC) and the Farm Improvement Loans Act, is the second most important lender in the farm market. Since 1959, FCC has been the prime supplier of fixed-rate loans. Loans are extended with amortization periods and fixed rate terms of up to 29 years, and are used mainly to finance purchases of farm real estate secured by mortgage. Initially, FCC obtained its funds from federal appropriations. In the mid-1970's, there were shortages as demand far outstripped supply. This occurred due to the large volume of farm real estate transactions and the policy of Farm Credit Corporation to extend loans based on the market value of assets. In 1978, the slack was picked up by the chartered banks, which introduced fixed and floating-rate loans with amortization periods of up to 25 years. In 1982, Parliament authorized FCC to borrow funds in foreign capital markets, enabling it to increase its lending powers. Since 1983, the demand for funds from FCC has decreased and the Corporation is now able to meet all feasible loan proposals.

The Farm Improvement Loans Act was introduced in 1945, initially for a three-year period. It has remained in force, however, with the latest extension enacted in 1985. Under the Act, farmers can borrow up to $100,000 from chartered banks with a guarantee by the federal government. The maximum repayment period for loans to cover the purchase of additional land is 15 years; for all other purposes, the term is 10 years. The interest rate can be no greater than the bank's prime plus 1%. In Ontario, approximately $16 million is currently guaranteed under the Farm Improvement Loans Act, an amount less than in other provinces, particularly in the West. Farm Improvement Loans offer attractive interest rates to borrowers and a good lending opportunity for the banks, so there seems to be room for expansion of this program. However, banks determine how heavily they want to be involved in the program, which is limited by the fact that only floating rate loans are guaranteed. Because one of the major impediments to good financial control is the volatility of interest rates, farmers who need federal guarantees to obtain medium-term credit could benefit from fixed rates on such loans.

The Taxation System

Taxation measures have a significant impact on the financial conditions of Ontario farms. Some tax measures apply directly to farmers and others are available to taxpayers generally. The following tax regulations apply specifically to farmers.

- Cash accounting.
- Optional livestock inventory valuation provision.
- Five-year block averaging of income.
- Depreciation of one-half the value of marketing quota.
- Deductibility as expenses of land clearing, levelling and drainage costs and treatment of any resulting increases in value as capital gains.
- Accelerated capital cost allowance for farm buildings for fruit, vegetable and grain storage.
- Relief from the requirement to make quarterly instalment tax payments by allowing semi-annual payments.
- $5,000 restricted farm loss provision for part-time farmers.
- Full deductibility of carrying charges on farm land.
- Farm property tax rebates
- Commodity tax exemptions or rebates (farm machinery and equipment, fertilizer, fuel, etc.)
- Intergenerational roll-over provisions.

In addition, as small business operators, farmers may qualify for the following.

- The Small Business Bond, if in financial difficulty.
- Special administrative rules for deducting home expenses for use as an office.
- The low rate of tax on small businesses if incorporated.
- Forward averaging, which minimizes the impact of higher marginal tax rates on fluctuating farm incomes.

- Deduction of the salary paid to the spouse and splitting income for tax purposes.

- The Investment Tax Credit.

- The replacement property roll-over of business properties when relocating or consolidating farming operations.

An assessment of the impact of tax measures on agriculture is underway by the Ministry of Treasury and Economics and the Ministry of Agriculture and Food.

Supply Management

Supply management by farmer-controlled marketing boards is the dominant system by which farmers in Ontario have streamlined the marketing of their products. Currently, 30% to 35% of gross farm revenues in the province are generated by the major regulated commodities: milk, tobacco, poultry and eggs. Hogs, vegetables and many other products are also marketed through producer organizations, but only milk, tobacco, poultry and eggs are considered to be under supply management because their organizations effectively control the quantities marketed in any given period. The Task Force has not attempted to evaluate the full social and economic costs and benefits associated with supply-management systems. However, the impact of quota on financing requirements and the cost of financing quota has been assessed. For details see Appendix D.

Supply management affects financing requirements through the need to own quota rights to market certain farm products. Since the inception of the various quota systems, these rights, or the assets to which they are attached, have acquired specific values because they are the most limiting factor of production on many farms. It is estimated that, at the end of 1984, the total investment in marketing quota in Ontario increased to $3.2 billion, representing 40% to 70% of all capital invested in farms producing the commodities in question. The effect of supply management has been to shift the relative investment requirement from tangible assets, such as land, buildings and livestock, to an intangible asset.

The impact of these shifts is most directly felt by new entrants and expanding farmers. The burden of financing quota constitutes a significant barrier to entry and eliminates a major share of the benefits of supply management for beginning farmers. For existing farmers the capital tied up in quota represents an opportunity cost. Supply management has contributed to the increase in the total capital requirements per farm because of the capitalization of expectations of both future quota appreciation and high operating returns.

Ownership

The traditional tenure structure (owner/operator) of farming is a major factor in the demand for farm capital financing. More than 90% of total Canadian farm assets are owned by the farmer-operator. Only about 6% of farms in Canada are outright tenant farms. Yet, it is estimated that 30% of farmland under cultivation is leased. Farms comprised of owned and leased land are on average 50% larger than farms that only use owned land. Therefore, it can be inferred that leasing as an instrument to control farm resources is more commonly used to expand existing operations than to start farming. Each time a new operator enters the industry, the largest part of the capital stock of that farmer needs to be financed. In the process, capital leaves the industry and new capital, often in the form of credit, enters. This puts particular pressure on beginning farmers who must pay higher interest rates because they usually do not have the same access to financing as well-established farmers. High capital investment requirements are also a burden on existing farmers who put most or all of their personal resources into the farm. This situation would be alleviated if farming assets could be rented or leased for longer terms. Beginning farmers could enter farming without the need for a large personal capital base and existing farmers could diversify their investments thereby generating earnings from other sources to make up for temporary farming income shortfalls.

Legislation Affecting Supply of Credit from Private Sector

There is an extensive body of legislation that affects the operation of the financial markets by governing the availability of credit through restrictions on interest rates and bank charges and through security, bankruptcy and insolvency regulations in Ontario.

The federal Interest Act was enacted to regulate the way interest may be charged on fixed-rate loans. It permits borrowers to renegotiate or pay off any fixed-rate loan from private and commercial sources after five years. Therefore, loans with rates fixed for more than five years are now unavailable, except from FCC. Because more than 70% of farm capital is tied up in land and buildings, it may make sense under particular economic conditions to finance with credit on fixed-terms for more than five years. Removal or amendment of the relevant provisions in the Act could increase the availability of long-term credit at rates fixed for more than five years.

The federal Farmers' Creditors Arrangement Act of 1934 invoked restrictions on the way lenders could deal with security in cases of default. While the reasons for the legislation at the time of its enactment have not been reviewed by the Task Force, it is clear that the ultimate effect of the Act was that some major sources of credit, such as insurance companies and pension funds, stopped dealing with the agricultural sector in Canada. Attempts were made in 1984 to revive the Farmers' Creditors Arrangement Act by way of Bill C-653. For a discussion of the pros and cons, see the July 22, 1985 Statement by the Honourable Jack Riddell (see Appendix E).

The federal Bank Act, which is reviewed about every 10 years, is designed to regulate the chartered banks. Currently, the Bank Act contains few obstacles to the free flow of credit from the chartered banks to the farm sector, but this has not always been the case. Until 1967, chartered banks could not easily extend term loans to farmers because the Bank Act imposed restrictions on mortgage security and a ceiling on certain interest rates. Consequently, these institutions supplied mainly short-term credit based on the traditional note system. In the early 1970's, as a result of economic conditions and the newly enacted Bank Act of 1967, the chartered banks entered the medium-term credit market. They became major participants in the long-term credit market in 1978.

Provisions of the Bank Act have a major impact on the availability of operating credit. Section 178 of the Act allows chartered banks to take as security, inventories, equipment, farm products and even crops that have not yet been produced. This facilitates the extension of operating credit, as without security over "crops in the ground," operating credit availability would be severely restricted. However, while Section 178 represents a credit-granting opportunity to chartered banks, other lenders cannot take such security. This is a serious impediment to the flow of trade credit, in particular from suppliers of materials that cannot be identified once used in the farm operation such as fertilizer, fuel, chemicals, seed and feed.

The only security for trade credit available to such suppliers are under the provisions of the Ontario's Personal Property Security Act. Under this Act, which is also used by chartered banks, suppliers can take what is known as a purchase money security interest in the goods they supply. This is similar to a conditional sales contract where the seller maintains part ownership of the goods sold until they have been paid for. However, the courts have yet to determine which statute takes precedence in the event of farm liquidation. The security status of trade suppliers, therefore, is at best uncertain, leading to a reluctance to provide credit beyond the normal 30-day period.

VII. ASSESSMENT OF EXISTING PROGRAMS

Over time, the Province has introduced a number of financial assistance programs. The Task Force has reviewed these programs to evaluate their effectiveness in meeting the requirements of today's environment.

Beginning Farmer Assistance Program (BFAP)

Description

The program provides a subsidy through a rebate of up to five percentage points for interest paid on fixed rate loans to purchase farming assets. An eligible applicant must never have owned a viable farm or spent the majority of time or earned the majority of income from farming assets over which he/she has had control through ownership, rental, leasing, etc. Eligibility criteria limit the benefits to those with a net worth of less than $200,000. The maximum loan amount for which participants may receive the interest rebate is $350,000. Between the program's inception in 1983 and the end of 1985, 1,919 loans were approved for a total of $235 million, with $9.6 million disbursed through rebates.

Objectives

BFAP assists beginning farmers with servicing the high capital costs involved in entering the industry and helps ensure that they develop sound financial and production management practices.

Cost

The original spending estimate for BFAP was $135 million over a 10 year period. As of December 1985, based on the volume of approved loans, $50 million is committed to be paid over the next seven years until the end of the program. It is estimated that under the current program guidelines, the total expenditures will amount to approximately $100 million as more applications are approved before December 31, 1987.

Evaluation

Pros:

- BFAP has received widespread support from the farming community as an effective measure to support beginning farmers and to ensure the continued viability of the farm sector.

- The program has assisted a large number of beginning farmers in purchasing the necessary assets to develop a viable farm operation in order to become full-time farmers in the course of a reasonable period of time (five years).

- The program has greatly contributed to the development of financial management skills among beginning farmers.

- The limit on total benefits per farmer has targeted the assistance to farmers who need the benefits.

<u>Cons</u>:

- The program does not provide for a phase-out period of the benefits causing farmers to be confronted with a substantial and sudden increase in debt servicing expenses at the end of the benefit period.

- Five years can no longer be considered a sufficient period to become well established in a farm operation.

- Arrangements of farm leases with an option to purchase are expected to become a major way by which beginning farmers can establish viable operations; BFAP cannot currently accommodate such arrangements.

- The eligible net worth levels beyond which benefits are reduced ($100,000) and are eliminated completely ($200,000) are lower than the level that may be necessary to establish a financially secure farm business.

- BFAP subsidizes the use of credit rather than the formation of equity.

Ontario Farm Adjustment Assistance Program (OFAAP) and Farm Operating Credit Assistance Program (FOCAP)

Description of OFAAP

The Ontario Farm Adjustment Assistance Program was introduced in January 1982 to assist in the financial and operational adjustments of farms experiencing financial difficulty. The program provides assistance through interest rebates, operating loan guarantees and an interest set-aside guarantee. It also provides a third-party review of the financial and operational arrangements of participating farmers.

The OFAAP phase-out began in 1985. Only the operating loan guarantee option remains with the last guarantee to expire on December 31, 1988. No new applications have been approved since 1984.

Description of FOCAP

In 1985, the Farm Operating Credit Assistance Program was introduced as the successor to OFAAP. FOCAP has three components:

- A guarantee of operating credit;
- An interest reduction grant to bring the effective rate on floating rate operating credit down to 9.75%; and
- A forum for review of the viability of the operation by an independent third-party peer group.

There is a major difference between the OFAAP and FOCAP guarantees. Under OFAAP, a residual loss guarantee is provided and a claim results in the liquidation of the farm operation. Under FOCAP, the guarantee applies only to the operating loan and in the case of a claim, only market inventory would be liquidated. The result is the elimination of the requirement that the farm must be liquidated in its entirety in the event of a claim.

Objectives

OFAAP and FOCAP provide assistance in the financial restructuring, reorganization and consolidation of farm enterprises experiencing financial difficulty, but which could be viable with assistance by way of loan guarantees, interest reductions and financial counselling. The programs are intended to assist farmers during a period of extraordinary economic conditions characterized by low commodity prices, reduced effective world demand for farm commodities and high interest rates.

Costs

Under OFAAP, the Province has spent $20.4 million through interest rebates over a three-year period from 1982-1984. Claims under the guarantees until the end of 1985 have amounted to $28.3 million.

As of April 1, 1986, no guarantees have been claimed under FOCAP. Interest rebates for 1985 totalled $731,000.

Evaluation

Pros:

- More than 1,000 farmers with long-term potential have been kept in business with operating credit guarantees.

- Interest reduction grants have enhanced farmers' cash flows and have provided a stable planning environment for farmers and lenders.

- The program has successfully introduced the concept of review by a third party (the Provincial Decision Committee and Local Case Committee), thereby enhancing the environment for working out adjustment plans between lenders and farmers in financial difficulty.

- The program requirement of producing comprehensive financial statements has contributed significantly to the development of farmers' financial management skills.

Cons:

- While the guarantee under OFAAP would have been effective had land markets not continued to decline from 1981, its effect was to cover lenders' past security deficiencies in some cases.

- The review forum does not always allow farmers to present their cases in the best possible manner. They don't always have the presentation skills required and they are usually unable to afford professional services.

- Because the improved conditions anticipated at the inception of the program have not come about, the turnaround in many operations has not yet occurred.

- Because of the continuation of the depressed situation in the commodity markets in some cases, the effect of staying in business was to increase losses by way of reduced equity as farm values continued to drop.

Ontario Family Farm Interest Rate Reduction (OFFIRR) Program

Description

OFFIRR was announced August 8, 1985, as a $50- million one-year grant program that effectively reduces the interest to 8% on up to $200,000 of existing long-term farm debt. The maximum interest reduction provided under the program is seven percentage points. This means that the maximum grant a farmer can receive is $14,000. Long-term debt is defined as that with an amortization period of two years or more. In order to qualify, farmers have to provide a complete set of financial statements, including tax assessments, personal net worth statements and a 1984 income statement on an accrual basis. Cash flow plans and production plans must also be provided.

Objectives

OFFIRR was established with the objective of providing emergency assistance by easing the financing burden of Ontario farmers who have accumulated high debt loads but have viable operations.

Costs

When OFFIRR was announced, the Ministry expected that up to 10,000 farmers would benefit under the program. The Ministry received over 10,600 applications by March, 1986 and is expected to provide total payments of about $50 million.

Evaluation

Pros:

- The program has provided immediate relief to farmers facing high debt loads and high interest rates.

- The program is targeted to a specific group.

- Applicants are required to submit a comprehensive set of financial statements that in many instances would not have been prepared, thus contributing to the development of better financial management methods.

- The applications for OFFIRR have created an important database for the analysis and assessment of the financial situation of farmers in Ontario, which will be of use in the development of future programs and policies for farmers.

Cons:

- The rebate is intended to provide interest relief and debt reduction, but there is a risk that the funds may be used for other purposes, such as new capital purchases.

- While OFFIRR was established as a one-year emergency measure, the economic conditions leading to OFFIRR have not changed.

- If OFFIRR were introduced on a sustained basis, the benefits might be capitalized into farm asset values and retard the required adjustments in the farm economy.

Ontario Young Farmer Credit Program (OYFCP)

Description

Under OYFCP, the Province provides a guarantee on intermediate term credit extended to young farmers when chartered banks and designated credit unions are not able to lend on commercial terms (owing to a lack of experience and/or lack of track record of the farmer in the financial management of a farm). Only farmers between 18 and 35 years of age are eligible.

Objectives

OYFCP is designed to assist young farmers in the establishment or expansion of their farm operations, and in the development of a profitable farm plan.

Costs

Since the program's inception in 1975, 375 loans have been guaranteed for a total of $12.4 million. As of December, 1985, 44 claims have been paid for a total of $1.3 million. Currently, approximately $3.4 million is guaranteed under OYFCP.

Evaluation

Pros:

- The administrative structure of the program has ensured that most loans guaranteed were repaid on schedule by the farmers.

- Participating farmers receive comprehensive counselling from local Ontario Ministry of Agriculture and Food staff in developing viable farm plans.

Cons:

- Administrative requirements for a comprehensive loan guarantee program are such that only a small number of farmers could be accommodated.

- When the program was initiated, guarantees were considered well-secured as the land market was rising; in a declining land market, recovery of payments under the guarantee is highly unlikely.

- The program overlaps to some degree with the federal Farm Improvement Loan (FIL) Program.

Farmers in Transition Program (FIT)

Description

Farmers in Transition provides wage subsidies, short-term living allowances, financial, stress and family counselling and a telephone Helpline for farmers in financial distress. The program also provides a deferral by the Province on its rights of collection under three of its assistance programs.

Objectives

FIT has two objectives: to assist farmers who want to stay in agriculture but require some assistance, and to assist farmers in their transition out of agriculture. It addresses the economic and social needs of farmers who are faced with losing their livelihood and their homes.

Cost

FIT was announced in the 1985 budget as a $6 million fund. It was originally estimated that the program would cost $1.3 million in 1985-86 and $4.7 million in 1986-87. Because of the late start of the program, the 1985/86 cost was under $50,000. Estimated expenditure in 1986/87 will be $5,000,000.

Evaluation

Pros:

- As of May 9, 1986, the FIT Helpline has received 844 calls with about 5% of the callers requesting counselling services from the Ministry of Community and Social Services.

- 99 farm families have applied for Re-establishment Assistance. Of these, all sought living allowances and 87 requested wage subsidies.

- 260 farm families are registered with Farm Family Advisors.

- FIT has received support from the agricultural community for providing assistance of a non-financial nature.

- FIT has facilitated the establishment of a mechanism through which the Ministry of Community and Social Services can participate with the Ministry of Agriculture and Food in providing social services in rural areas. Through the Helpline, several farm families have been put in touch with family and stress counselling agencies.

. FIT is the first program of its kind. It recognizes the difficulty of farmers displaced from agriculture and responds with assistance intended to ease their transition into other occupations. In the February 26, 1986, budget, the federal government followed Ontario's lead with the announcement of the Canadian Rural Transition Program.

Cons:

. FIT is the only program offered by Ontario that provides wage subsidies to adult workers; this could cause criticism from other sectors that are dealing with displaced workers.

. FIT also provides a greater living allowance than is available under General Welfare Assistance.

. The amount of assistance under FIT is small when it is considered that the displaced farmer may have lost his or her job, savings and home and does not have access to unemployment insurance and many of the retraining programs available to other groups.

VIII. PROPOSALS CONSIDERED BY THE TASK FORCE

Proposals were submitted by a number of organizations and individuals concerned with the farm sector. See Appendix A. This section provides a description of 29 proposals for new programs that were suggested in the submissions. The following proposals were put forward:

- Program to facilitate technology transfer and demonstration
- Low-cost credit for productive investments
- Provisions for BFAP participants who lease land with an option to purchase
- Phase out of assistance for existing BFAP participants
- Agribonds
- Debt review boards with powers
- Debt review boards without powers
- Farmers' bank
- FCC guarantee of mortgages provided by private individuals
- Equity financing through a Small Business Development Corporation type of arrangement
- Encouragement of share-farming and leasing arrangements
- Interest subsidy for farmers in financial difficulty shared jointly by lenders and government
- Interest rate insurance
- Accrued interest mortgages
- Variable amortization mortgages
- Graduated payment mortgages
- Split risk mortgages
- Shared appreciation mortgages
- Inclusion of fixed rate loans under the federal Farm Improvement Loans Act.

- Registered farm investment fund
- Inflation adjusted borrowing rates
- Commodity price indexed loans
- Legislative changes to remove impediments to the efficient operation of the farm credit market
- Expansion of FCC's mandate into the intermediate-term credit market
- A program to encourage farmers to leave agriculture
- A moratorium on farm foreclosures and forced liquidations
- Wholesale purchasing association of farmers
- Rejuvenation of the Ontario Junior Farmer Establishment Loan Corporation
- Technology fund

Program to Facilitate Technology Transfer and Demonstration

Description

Grants of up to 30% of the investment in new technology would be provided to a maximum grant of $10,000. Farmers receiving grants would be required to help demonstrate the technology and its results to others in the area.

Objectives

To create a link between research, extension and advisory services. Farmers would be able to evaluate techniques that have proven effective under experimental conditions or in other regions, but that have not been put into practice under local, farming conditions.

Estimated Cost

A fixed fund would be established under the supervision of a board of directors chosen from the industry, including extension personnel, academics and farmers. Assuming 200 projects are approved annually at an average cost of $20,000, the program cost would be $1.2 million annually, plus a budget for administrative and auxiliary expenses.

Evaluation

Pros:

- Increased average productivity and improved competitiveness of the agricultural sector in Ontario.
- Reduction of the gap between available technology and applied technology.
- Promotion of technologies which are most appropriate for the varied agronomic conditions.
- Benefits are highly visible and widespread.
- Technology transfer is clearly within the provincial mandate.
- Administration is relatively easy and straightforward.

Cons:

- May encourage uneconomic investments if not strictly controlled.
- Difficulty in defining eligible technology.

Low Cost Credit for Productive Investments

Description

An annual interest rebate on loans of up to $50,000 per eligible farmer for medium term investments would be provided to bring the effective interest rate down to 8%. Benefits would be available for five years.

Objectives

To reduce the debt servicing costs associated with farm capital investments.

Estimated Cost

Assuming 2,000 farmers per year apply for an average loan of $40,000 and a base rate of 12%, the cost in the first year would be $3.2 million. The second-year cost would be $6 million, and in the fifth year the cost would rise to $12 million. It would stay at that level for as long as new applications were accepted.

Evaluation

Pros:

- Would reduce the impediment to investment in agriculture created by high real interest rates.
- The plan would assist farmers who are adjusting their operations to the more competitive environment.
- Benefits are highly visible.
- Interest rebates are clearly within the mandate of the Province.
- The money would be targeted to efficient farmers making worthwhile investments.

Cons:

- May encourage uneconomic investments.
- Benefits may be capitalized into asset values.

Provisions for BFAP Participants Who Lease Land With an Option to Purchase

Description

Where BFAP participants lease a farm with an option to purchase and choose to exercise the option within five years, the lease payments would be deemed to have been loan payments and a lump sum BFAP payment would be provided upon exercising the option to purchase. If the lease period is less than five years, then BFAP payments would continue until the end of the five-year period on the loan taken out.

Objectives

To assist those who wish to begin farming without the purchase of land. The lump-sum benefit may be used to increase the down payment when the option to purchase is exercised.

Estimated Cost

Cost would be similar to other forms of BFAP participation, but payment would be deferred. Because this option would be a substitute for outright purchase, there be no increase in the number of applicants.

Evaluation

Pros:

- Lease with option to purchase is a prudent and effective way to enter farming.
- With lenders such as FCC having a substantial number of vacant properties to offer, the opportunities for leases with purchase options have become more prevalent.
- Allows beginning farmers the opportunity to enter the industry without immediately purchasing a farm.
- The lump-sum payment may allow a larger down payment when the purchase is made, thereby reducing the debt burden.

Cons:

- Requires substantial changes to administrative structure and may not be feasible unless BFAP is extended after 1987.

Extension and Phaseout of Assistance for Existing BFAP Participants

Description

An extension with a four year phaseout of benefits after the first five years of entitlement would occur. In the sixth year, a rebate of the difference between the FCC rate and 9%, to a maximum of four percentage points would be provided. In year seven, the rebate would be the difference between the FCC rate and 10% to a maximum of four percentage points and so on.

Objective

To allow a gradual adjustment to higher interest costs for BFAP recipients.

Estimated Cost

The expected cost is $36 million between 1988-89 and 1998-99.

Evaluation

Pros:

- Would further demonstrate the Province's commitment to assist beginning farmers.
- An extension of the benefit period from five to nine years would more closely match BFAP with the period required to get a farm on a sound financial footing.
- The concept has the support of farm organizations and the BFAP Review Committee.

Cons:

- Benefits would be committed for at least 10 years after the last application is taken.

Agribonds

Description

Agribonds are debt instruments created to finance agriculture. They are generally understood to involve tax concessions to investors in order to encourage them to provide funds below market levels.

Objectives

To increase the credit available to agriculture and to make credit available at concessionary rates and terms.

Estimated Cost

The cost of Agribonds to the Government depends on whether tax concessions are part of the package. Cost would include administrative expenses and foregone taxes.

Evaluation

The Task Force has evaluated Agribonds as one of many mechanisms to increase the flow of farm credit at concessionary rates; the need for such credit is not evaluated here.

Pros:

- Provides lower interest rates to farmers.
- Possible to target the benefits to specific farm groups.

Cons:

- Tax system is already complex.
- Difficult to determine the exact cost through foregone tax revenues.
- Could put pressure on governments for similar programs for other sectors.
- Investors would receive some of the benefits of foregone tax revenues, which would not be an objective of the program and the cost of which would reduce the funds available for benefits to the targeted farmers.
- Requires federal legislation.

Debt Review Board With Powers

Description

A third party debt review board would be established by the federal government (it has the appropriate legislative mandate) to review farm lender-borrower disputes and impose its decisions regarding debt concessions or refinancing arrangements on creditors.

Objectives

To shift the balance of power away from creditors and toward borrowers, to force lenders to bear a larger portion of the costs of poor farm investment decisions which they may have endorsed or encouraged and to ensure the retention of competent farmers who get into difficulty through no fault of their own.

Estimated Costs

Administrative cost of the board.

Evaluation

Pros:

- May prevent the loss of potentially successful farmers

- Would institutionalize the debt adjustment process already undertaken by lenders on an individual basis, thereby enhancing the equity of treatment in all regions and by all lenders.

Cons:

- Lenders would be hesitant in lending to farmers who are in a risky position and may even withdraw from farm lending.

- May encourage borrowers to take on risky or uneconomic ventures and discourage them from repaying lenders.

- If write-downs to levels that could be met by cash flow are applied, poorer managers would receive larger write-downs and benefit more than frugal or skilled managers.

- Because market values are above productive values, writing down assets to security values would not necessarily result in a financially feasible family operation.

- Unless provision for further operating credit is made as part of the debt restructuring plan, a continuation of the farm by the same operator(s) may still not be possible.

- Debt concessions may require government funds to compensate the borrower and/or the lender for bad luck and/or poor management.

- Requires federal legislation.

Debt Review Boards Without Powers

Description

A third-party debt review board would be established by the Province or the federal government to review lender-borrower disputes and suggest a resolution. The agency would not have the authority to impose its decision.

Objectives

To offset the unilateral power held by creditors in farm loan disputes and to encourage equity in lender concessions to borrowers.

Estimated Cost

Administrative costs of the Board.

Evaluation

Pros:

- May prevent the loss from agriculture of potentially successful farmers.

- If the board were composed of farmers, as well as banks and government, it would promote confidence and would help to assure farmers that they received due process.

Cons:

- Potential overlap with Farm Family Advisor initiative and FOCAP Provincial Decision Committee.

- May be viewed as ineffective.

- May discourage informal discussions and arrangements.

Farmers' Bank

Program Description

A bank operated on a non- or low-profit basis would be created to lend solely to farmers.

Objectives

To set up a bank dedicated to agriculture that would form a reliable partnership with farmers and would offer services at lower cost than financial institutions can.

Estimated Cost

A farmers' bank would be an economically independent institution. Government financial assistance would not be necessary.

Evaluation

Pros:

- Would create a bank with special knowledge of agriculture.
- Borrowers may be more able to rely on the bank staying with them in bad times.
- Would provide competition for major banks.
- Would enable farmers to help each other by investing surplus funds from rural areas in farm assets.

Cons:

- Cost of entering business (branches, staff training, etc.) would be very high.
- Single-line loan portfolios are riskier than diversified portfolios, making a farmers' bank significantly less attractive for some depositors and raising the cost of funds.
- Interest costs could not be lower than those of major banks and might even be higher because of higher risk.
- It is unlikely that the bank would be able to help farmers with little equity and poor cash flow.
- National farm organizations showed little interest in participating in a study to examine the possibility of a farmers' bank when requested in 1984.

FCC Guarantee of Mortgages Provided By Private Individuals

Description

The federal government, through the Farm Credit Corporation, would set up a program under which private individuals who provide long-term financing to farmers would have their loans guaranteed.

Objectives

To provide farmers with additional long-term credit sources at rates below current market levels through government guarantees on privately financed long term farm loans.

Estimated Costs

The Farm Credit Corporation would receive an administration fee similar to its spread on regular loans. This fee should cover the costs of administering the loan as well as providing a contingency for claims on the guarantees. It is estimated that an annual fee of 1% of loans outstanding would cover all costs.

Evaluation

Pros:

- Expands the amount of reasonably priced credit available to farmers, including beginning farmers.
- Reduces interest rates to below market rates because of the guarantee and lower costs associated with financial intermediation.
- Provides opportunities for retiring farmers, or those with surplus cash, to retain secure investments in agriculture.
- Reduces the cost of credit to farmers with no direct interest subsidy cost to government.
- FCC already has the infrastructure to administer and supervise the guarantees.

Cons:

- Requires federal action; the Province does not have the infrastructure to administer and supervise guarantees and the cost of developing one is prohibitive.
- Non-armslength arrangement may be difficult to administer and supervise.

Equity Financing Through SBDC-Type Arrangement

Description

A grant or tax credit would be given to investors who purchase shares in a farm corporation; the corporation could be patterned after Ontario's Small Business Development Corporation program.

Objectives

To encourage private-sector investment in agriculture with a view to reducing the dependence of farmers on the credit market.

Estimated Cost

The cost to the government, by way of foregone tax revenues, is dependent on the demand for this type of financing and the level of tax incentives created.

Evaluation

Pros:

- Reduces the requirement for debt financing.
- Provides additional financial expertise for the farm operation as investors become involved in the management of their assets.

Cons:

- With declining farm asset values and prospects for continuing low operating returns, investor participation may be discouraged.
- Farmers may be hesitant to participate because equity investment would mean the participation of investors in the ownership of assets and in the management of the farm operation; this would require farmers to give up a portion of their profits and their autonomy.
- Government could be called upon to provide guarantees, given the potential for uncertain returns.

Encouragement of Share-Farming and Leasing Arrangements

Description

A start in farming by entering long-term leasing or share-farming arrangements as an alternative to debt-financed farm purchases would be encouraged through information and promotion by the Ontario Ministry of Agriculture and Food. Included in information would be examples of appropriate lease arrangements and documents.

Objective

To encourage beginning farmers to enter agriculture without the need for immediate financing of a farm purchase and to reduce the future incidence of farm failure and financial stress related to high debt financing costs associated with purchasing of expensive capital assets.

Estimated Cost

Part of overall extension effort.

Evaluation

Pros:

- Encourages the farming community to reconsider the notion that a farmer must own the farm he or she operates.
- Encourages farmers to view the purchase of farm assets as a business decision, not as a requirement of farming.
- Mechanism for retiring farmers to gradually wind down involvement in the farm business and to share expertise and skills with individuals entering the business.
- Increased opportunity for beginning farmers to enter agriculture without the large initial equity required to purchase a farm.

Cons:

- Would be resisted by the farming community, which generally believes that total farming independence can be achieved only by farm ownership.
- May result in some legal conflicts over rights of participants.
- Subsequent land purchase may be ineligible for BFAP.

Interest Subsidy for Farmers in Financial Difficulty Shared Jointly by Lenders and Government

Description

Interest assistance would be provided to farmers who, under current conditions, have little financial incentive to continue farming but who could return to profitability. Reduced debt servicing costs would be available to farmers until cost/price relationships returned to more favourable levels. The cost of debt set-aside and/or interest reduction would be shared by lenders and the government.

Objectives

To provide an incentive to farmers and lenders to keep farmers with a good management history in the industry.

Estimated Cost

Government interest assistance of up to five percentage points, could be matched by equal assistance provided by the lender. Assuming 1,500 farmers with an average debt of $200,000 would participate, the annual cost to Ontario would be $15 million.

Evaluation

Pros:

- Farmers in financial difficulty would be able to continue production with a view to renewed profitability when commodity markets have regained strength.
- The program would be targeted to farmers who deserve and need the relief; lenders would not be willing to participate if there was no hope or need to assist a farmer.
- Taxpayer contributions would be matched by financial concessions from lending institutions.
- The cost to the government would be limited because lenders would attempt to keep their own costs down.

Cons:

- May result in a Provincial contribution where lenders might otherwise have provided the full interest reduction in the absence of a government program.
- Overlaps with OFFIRR, Small Business Bonds and FOCAP.
- Cost/price relationships may not improve for some time.
- Success of the program depends on improved farm incomes.

Interest Rate Insurance

Description

Insurance against interest rate increases would be provided to farmers. Varying degrees of coverage would be sold at compensatory premiums. The farmer could be responsible for the first 2-3% of a rate increase above an established level and the program would then provide full or partial compensation for further increases.

Objectives

To provide protection against major interest rate increases on commercial mortgages.

Estimated Costs

Premiums would be established with the intent of covering the cost of the program.

Evaluation

Pros:

- Provides interest rate stability for borrowers on long-term credit costs.

- Enables the borrower to plan investments and expenses more effectively.

- Potential for program to be self-financing if premiums are collected at an appropriate level.

- Reduces the likelihood of default by the borrower, thus reducing risk to the lender.

Cons:

- Unlike true insurance schemes, the event insured against would affect a large proportion of the policyholders simultaneously; therefore it is not commercially insurable and would require government involvement.

- If premiums did not cover losses, the government would be liable for funding the difference between claims paid and premiums collected.

- It is difficult to estimate the probability of future increases in interest rates and therefore difficult to predict the cost of the program and the premiums that would be needed to cover costs.

- Farmers might use the program more extensively in unsettled economic times, than in times of economic stability thus increasing the insurer's risk.

- Those most affected by interest rate instability are least likely to be able to afford the premiums.

Accrued Interest Mortgages

Description

Accrued Interest Mortgages work on the principles of variable interest rates and fixed payments by way of adjustment of principal. The amount of each installment is fixed for a certain period of time, for example five years. The payment is based on a specific amortization period and the expected average interest rate for that period. The actual rate would fluctuate with the prime rate. At the end of each payment period, a calculation could be made to determine whether additional interest was owing, or whether too much interest was paid. At that time, the principal of the loan outstanding would be adjusted accordingly. Accrued Interest Mortgages could be made available by commercial institutions and/or Farm Credit Corporation.

Objectives

Accrued Interest Mortgages are lending instruments that would enable the borrower to predetermine cash flow requirements while not being tied to a fixed interest rate. This would be advantageous when interest rates are high and are expected to drop.

Estimated Cost

The cost of Accrued Interest Mortgages would be carried by the borrower, without cost to the Province. Since there is a small increase in risk for the lender, the rate for this type of loan would be higher than for regular floating-rate loans.

Evaluation

Pros:

- Stabilizes loan payments.
- Reduces risk of failure to service debt during fixed payment period.
- Commercial lenders and FCC could implement this type of instrument.
- No direct government involvement.

Cons:

- If interest rates increase, the accumulated debt at the end of the fixed payment period increases accordingly.
- Increases risk because interest accumulates when rates are higher than expected.

Variable Amortization Mortgages

Description

This type of mortgage is characterized by either floating or fixed rates, but variable amortization depending on farm income. The annual repayment of principal is accelerated in years of high income and decelerated, discontinued or even reversed in years of below-average income. To do so, a debt reserve is established as part of the original loan. It is used to service the loan if below-average incomes occur before above-average years. Variable Amortization Mortgages could be arranged by commercial lenders and/or FCC.

Objectives

To reduce the risk of farm failure by synchronizing debt servicing expenditures with farm income.

Estimated Cost

The cost of this type of debt instrument would be borne by the borrower.

Evaluation

Pros:

- Debt servicing requirements are adjusted to match farm income.
- Can be implemented by commercial credit institutions.
- No direct government involvement.

Cons:

- Does not reduce debt servicing requirements.
- Would require larger debt to provide for debt reserve; this would increase the cost of the loan.

Graduated Payment Mortgages

Description

Under this type of mortgage, the payments are not fixed, but increase over the repayment period.

Objectives

To reduce debt servicing requirements in the initial years of the loan.

Estimated Cost

The cost of this type of debt instrument would be borne by the borrower; there would be no cost to government.

Evaluation

Pros:

- Increased leverage for farm borrowers.
- No direct government involvement.

Cons:

- Increased debt servicing requirements in the later years of the loan.
- Increased risk for the lender and in turn more costly to the borrower than conventional mortgages.
- Because farm incomes are uncertain, repayment of the loan might become difficult if, in later years, incomes do not increase as is required to service debt.
- Might encourage over-extension by farm borrowers.
- The effective cash flow relief in the initial years of the loan is low.

Split Risk Mortgages

Description

Under a Split Risk Mortgage, the fluctuations in the interest rate are shared by the lender and the borrower. At the beginning of the loan a base rate is established. At each review, a new rate is established, based on the base rate plus or minus a portion of the difference between the base rate and the current rate. As a result, the interest rate risk is shared between the lender and the borrower. Currently, FCC is the only institution that takes Split Risk Mortgages.

Objectives

To protect borrowers from interest volatility and to allow them to partially benefit from lower rates while not being subject to the full cost of rising rates.

Estimated Cost

None to the Province.

Evaluation

Pros:

- Reduces interest instability for borrowers.
- Can be implemented by commercial lenders.
- No direct government involvement.

Cons:

- For heavily leveraged borrowers, the remaining risk of interest increases might still be too high.

Shared Appreciation Mortgages

Description

A Shared Appreciation Mortgage is a financial instrument through which the lender accepts a reduced rate of interest in return for some share of the capital gain of the asset being financed during the life of the loan.

Objective

To reduce debt servicing cost on long-term financing.

Estimated Cost

The farmer would pay by sharing the future capital appreciation of the asset. The lender would charge a lower rate of interest on the loan to receive an opportunity to share in appreciation.

Evaluation

Pros:

- Enables the farmer to pay lower interest rates on long-term debt.
- May provide some stability in interest costs for the farmer.
- Increases the farmer's net cash flow.
- Market-oriented approach which reduces interest costs for the farmer in return for a share of asset appreciation to the lender.

Cons:

- General participation by farmers is likely to be weak because of reluctance to share equity gains.
- Farmers would have to buy back or refinance the lender's portion of shared appreciation if they desired full ownership.
- A firm policy on the tax treatment of the shared appreciation component would have to be established.
- Depending on the tax treatment and the marginal tax rates of both parties, income-tax revenue over time could decline.
- There may be limited use for the instrument because of the difficulty in determining the appropriate trade-off between shared asset appreciation rates and reduced interest rates.
- Unless the asset is sold at the end of the loan period, it would be difficult to determine the capital gain; hence a source of friction and cause for costly litigation and/or arbitration.
- Lenders would only participate when asset appreciation is forecast.

Inclusion of Fixed Rate Loans Under the Federal Farm Improvement Loan Act

Description

The federal Farm Improvement Loan Act would be amended to include an option for a fixed rate on Farm Improvement Loans.

Objectives

To overcome uncertainty associated with unstable interest rates during the repayment period of term loans. To provide term loans at reasonable rates to higher risk borrowers.

Estimated Cost

No cost to the Province.

Evaluation

Pros:

- Encouragement for lenders to continue supplying credit.
- Greater certainty of debt servicing requirements.
- Encourages capital improvements and updating of technology on farms.

Cons:

- Would increase federal government contingent liabilities.
- Section 174(5) of the Bank Act allows for unconditional prepayment of fixed-rate loans under $50,000 not secured by mortgage; unless Farm Improvement Loans were exempted, uptake by lenders would be negligible.
- Requires federal implementation.

Registered Farm Investment Fund

Description

The program would provide a mechanism to encourage the accumulation of capital prior to entering the business of farming. There could be an opportunity to roll funds from a Registered Retirement Savings Plan to the Registered Farm Investment Fund. Tax sheltered funds would grow more rapidly than regular term deposits, creating an opportunity to build more equity before beginning farming.

Objective

To assist prospective farmers to build equity that can be applied to the purchase of a farm.

Estimated Cost

The cost to government would be in foregone tax dollars in the years that contributions are made. Assuming a maximum 10-year contribution period, and assuming 700 potential farmers contributed $5,000 per year and their marginal tax rate was 30%, the revenue foregone would be $10.5 million per year on a sustained basis.

Evaluation

Pros:

- Prospective farmers are encouraged to save.
- Would be more targeted than Registered Home Ownership Savings Plans, which beginning farmers were once able to use to help buy farm property that included a home.
- Beginning farmers have more at stake with accumulated equity capital and may manage more wisely.

Cons:

- There is potential for abuse if funds are not used for purpose of buying a farm.
- Federal implementation is unlikely, since the RHOSP was cancelled.

Inflation Adjusted Borrowing Rates

Description

A loan instrument would be created with the interest rate fixed at a certain margin over inflation. The rate could change monthly, based on Statistics Canada's Consumer's Price Index or another accepted inflation index.

Objective

To fix the real cost of borrowing.

Estimated Cost

The cost would be borne by the borrower, who would have the choice of whether to pay a premium for the privilege of such a loan.

Evaluation

Pros:

- Financing risk and cost could be reduced.

Cons:

- It is difficult to determine the relationship between market rates and real rates, so the premium charged for the privilege may prevent demand for a commercial credit instrument of this nature.

- If the relationship between the general inflation index and the price index of farm commodities varies, the effectiveness of this approach cannot be determined.

Commodity Price Indexed Loans

Description

A loan instrument would be created whereby the interest is fixed but the loan balance is linked to the price index of agricultural commodities and/or agricultural inputs.

Objective

To reduce financing risk for highly leveraged farmers.

Estimated Cost

Such loans could be offered by any lender who is willing to assume some of the commodity price risk. Commercial lenders could be compensated for such loans by establishing the base rate above the market rate or by government participation.

Evaluation

Pros:

- Financial risk to the borrower would be reduced because in bad years the costs of servicing debt would be less.
- Commodity risk is shared between borrower and lender.
- Price risk to the borrower is decreased as at least part of it is borne by the lender.
- Lenders could hedge against increased lending risks through futures trading.

Cons:

- Only large lenders could carry the increased loan risk and carry out an adequate hedging strategy.
- Farmers would find such a loan attractive when commodity price rises are expected to be poor while lenders would be more attracted when healthy price gains are likely.

Legislative Changes to Remove Impediments to the Efficient Operation of the Farm Credit Market

Description

The farm credit market is characterized by provincial and federal legislation that determines the ground rules by which borrowers and lenders can formulate farm credit arrangements. Currently, there are several restrictions on the farm credit market that could be removed in order to improve accessibility to farm credit. In particular, the following statutes are involved: the Interest Act (federal), the Bank Act (federal) and the Trust Companies Act (Ontario).

Objectives

To remove inefficiencies in the farm credit market created by the statutory framework and to ensure that farm credit is available at competitive rates.

The Interest Act - Section 10

Section 10 (1) of the Interest Act stipulates that, where the interval from the date of a mortgage to the due date is more than five years, an individual mortgagor may, at any time after five years, repay the mortgage by tendering the principal and accrued interest owing, provided a further three months' interest bonus is paid to the lender. This section is one of the major causes for the lack of availability of commercial mortgages at rates fixed for more than five years. Only FCC is exempt. Repeal of this section would create the possibility of loans with rates fixed for more than five years. Under certain economic conditions, this may be to the advantage of farm borrowers.

The Bank Act - Section 174

Section 174 of the Bank Act stipulates that loans of less than $50,000, not secured by mortgage may be repaid without penalty at any time. This is one of the major causes for the absence of fixed-rate bank loans for farm equipment. This piece of legislation is typically consumer oriented, but an exemption for farms and businesses would pave the way for the introduction by the chartered banks of fixed-rate loans for farm equipment, livestock, etc.

Trust Companies Act

According to this Act, trust companies are restricted in lending to commercial borrowers if the loans are not secured by mortgage. This is responsible for the absence of the trust companies from the major segments of the farm credit market. Amending the legislation governing uses of trust company funds will create the possibility for such lenders to become major players in the farm credit market, adding to competition.

Estimated Cost

The direct cost of changes to legislation is not significant.

Evaluation

Pros:

- Removal of statutes limiting competition in the farm credit market would improve availability of reasonably priced credit at terms commensurate with the nature of farm investments.

Cons:

- The loss of protection against high interest costs under the Interest Act and Bank Act when rates are falling.
- The process to change legislation is lengthy and complicated.
- Federal cooperation required for some of the legislative changes.

Expansion of FCC's Mandate Into the Intermediate Term Credit Market

Description

FCC would be expanded from the long-term credit market to include intermediate term loans. These would be for any farm capital investment including implements, equipment, breeding stock etc.

Objectives

To provide a specialized banking service to farmers by an institution with a commitment to the farm market.

Estimated Cost

No cost to Ontario.

Evaluation

Pros:

- A bank with expertise in the farm credit area.
- A bank offering a line of services specifically attuned to the needs of the farmer.

Cons:

- Single line banking operation is exposed to higher risks than full service banks serving many economic sectors.
- Would require federal legislation.

A Program to Encourage Farmers to Leave Agriculture

Description

This program would provide an incentive to farmers to quit farming through a buyout of assets.

Objective

To reduce the following: the incidence of farming on marginal and unproductive soils; the average industry cost of farm production; and the supply of farm products to a level where cost of production is matched by product prices.

Estimated Cost

Depending on the program, the costs to Ontario would be prohibitive. One suggestion involved the payment of $2,037 per sow taken out of production. To reduce hog production by 10% would cost $84 million.

Evaluation

Pros:

- Would improve the average productivity of farming.
- Would reduce financial difficulties among participating farmers.
- Would provide participating farmers with funds to start in another occupation or to retire.

Cons:

- Relatively expensive.
- Would be difficult to ensure that the assets are taken out of production and remain so.
- No assurances that funds would not go to reduce creditors' losses.
- The limits on production would induce higher prices only if Ontario closed its borders for agricultural products. This would be unconstitutional when done without the consent of the other provinces and the Federal Government.
- Some of these assets would be taken out of production without government assistance.

Moratorium on Farm Foreclosures and Forced Liquidations

Description

Legislation would be enacted to restrict the powers held by secured creditors against borrowers. Particularly, creditors would not be able to proceed with actions to recover their funds.

Objectives

To allow farmers in financial difficulty to continue to control their assets and to deal with them in their own best interest.

Estimated Cost

No cost to the Province.

Evaluation

Pros:

- Would shift the balance of power in the credit relationship in favour of the borrower.
- Would reduce "fire-sale" disposal of farm assets.
- Would allow financially distressed farmers to keep their farms.

Cons:

- A moratorium could cause lenders to withdraw at least partially from the farm credit market, reducing the supply of credit.
- The cost of farm credit would rise because lenders would require increased coverage for the loan risk.
- Lenders would be more selective in extending credit.
- Would not keep financially distressed farms in production because lenders could refuse to extend operating credit.
- Requires federal legislation to implement.
- A government imposed moratorium would interfere with the normal relationship between borrowers and lenders.

Wholesale Purchasing Association of Farmers

Description

An association of farmers would be created to pool buying power in the farm input markets. Products dealt with would include fertilizer, chemicals, fuel, other materials, implements, etc.

Objectives

To reduce the cost of farm inputs by combining purchasing.

Estimated Cost

No cost to the Province.

Evaluation

Pros:

- Potential to reduce the cost of inputs.
- Farmers would be able to set specifications for farm inputs more strictly, thus improving quality.

Cons:

- There is already such an organization - United Co-operatives of Ontario.
- Start-up costs would be substantial and would possibly require government assistance.

Rejuvenation of the Ontario Junior Farmer Establishment Loan Corporation

Description

The Ontario Junior Farmer Establishment Loan Corporation, which extended long-term loans secured by mortgages to young farmers, would be re-activated. The last loans were extended in 1969.

Objectives

To assist beginning farmers with the establishment of a viable farm operation.

Estimated Cost

Could be run on a cost-recovery or a subsidized basis.

Evaluation

Pros:

- Could be used to administer programs eg. credit subsidies.

Cons:

- Since 1983, interest assistance for beginning farmers has been through the Beginning Farmer Assistance Program.
- The FCC now provides this service.
- The Provincial government lacks the administrative structure and the establishment of one would be expensive.
- Since 1977, private financial institutions have been extending long-term loans secured by mortgages.
- The benefits of concessionary rates, if provided on a broad basis, may be capitalized into farm asset values.

Technology Fund

Description

A fund would be created to assist the agricultural sector to adopt new technology in order to maintain or improve the sector's competitiveness.

The fund could be administered by a board comprised of farm operators, specialists in agriculture and government representatives. Within a framework set by the Province, the board would invite proposals from the agricultural sector, evaluate them and determine the appropriate level and type of assistance. The assistance could be through grants or loans.

The Fund would have two main thrusts:

- Funding new technology for demonstration purposes.
- Assisting productivity improvement.

Objectives

To provide assistance for investment in technology. Although a large number of Ontario's farmers are earning an adequate living from their farms, many of them have difficulty financing the acquisition of new technology to adjust their operations to the changing economic environment.

Estimated Cost

Cost is dependent on the stringency of the criteria imposed by the board.

Evaluation

Pros:

- A flexible structure that can respond to varying needs.

- The agricultural community would be involved with the decisions.

- Investments in new technology frequently have high returns.

- Competitive pressures require adoption of new technology, new products and reduced production costs.

Cons:

- Selection criteria and allocation of funds will be difficult and possibly controversial.

- May encourage some farmers to acquire too much debt.

- Benefits may be capitalized into farm asset values.

IX. CONCLUSIONS AND RECOMMENDATIONS FOR ACTION

The Task Force directed its attention to a wide range of recommendations aimed at beginning farmers, existing farmers (including those in financial difficulty) and exiting farmers. In addition to recommending specific initiatives for immediate implementation, the Task Force also recommends items to be implemented in the medium term and suggests areas where further study would be valuable.

The following premises have been the focus of the Task Force in its development of the recommendations.

Agriculture is undergoing significant structural adjustments. Stagnating or falling commodity prices, combined with rising costs, are reducing profitability of the industry. The resulting reduction in asset values is causing a further deterioration in farmers' wealth. This situation was precipitated by changes in the Canadian and world economies as well as changes in the global market for agricultural commodities.

Ontario farmers, agribusiness and rural communities are experiencing economic and social hardship caused in part by factors beyond their control, such as the cost of credit and commodity prices. The spread between farm returns and expenses has also been influenced by individual production efficiency and marketing management.

Governments can mitigate the most harmful effects of the transition to new economic realities, but cannot reverse trends in the global economy. If Ontario agriculture is to be competitive in world markets in the years ahead, governments should not interfere unduly with market processes. These processes are reducing the costs of production and contributing to improved aggregate levels of productivity and marketing efficiency, both through the exit of less efficient farmers and through improved business practices of those who remain. Still, part of government's role is to ensure that the industry is not so badly weakened by short-term adverse economic conditions that it is unable to take advantage of emerging opportunities.

For Immediate Implementation

Beginning Farmers

1. Amend the Beginning Farmer Assistance Program (BFAP) as follows.

   - Increase the benefit period for individual participants from five years to nine years, gradually reducing the benefits in each of years six through nine.

   - Increase the net worth criterion by $100,000. Full benefits would be available to those with a net worth of up to $200,000, and partial benefits would be available to those with a net worth of between $200,000 and $300,000.

2. Allow participants in the Beginning Farmer Assistance Program to apply for benefits under an extended Ontario Family Farm Interest Rate Reduction Program. The amount of loan eligible for benefits under OFFIRR would be reduced by the amount of loan covered under BFAP.

Ongoing Operations

3. Expand and enhance the Ontario Family Farm Interest Rate Reduction Program as follows.

   - Provide full benefits for 1986, followed by a phaseout providing 70% of benefits for 1987 and 40% of benefits for 1988.

   - Increase the net worth criterion by $200,000. Full benefits would be available to those with a net worth of up to $500,000 and partial benefits to those with a net worth between $500,000 and $700,000.

4. Expand and enhance the Farm Operating Credit Assistance Program (FOCAP) as follows.

   - Reduce the effective interest rate payable by the farmer to 8% from 9.75%, subject to a five percentage-point cap.

   - Increase the maximum allowable equity to 75% from 60%.

   - Extend program eligibility to currently excluded agricultural commodities (eg. sod, flowers, fur).

   - Discontinue coverage of floating-rate term loans and provide benefits only on operating loans, beginning in 1987.

5. Provide a continued educational thrust across Ontario to ensure that farm lenders, advisors and borrowers have the opportunity to learn and develop appropriate financial skills at agricultural colleges and through seminars and courses. Undertake a continuous review of financial management tools to ensure that the most appropriate tools are available..

6. Encourage the federal government to introduce income support measures, possibly through enhanced stabilization, to mitigate the short-term adverse impact of the 1985 U.S. Food Security Act.

Exiting farmers

7.(a) Continue the Re-establishment Assistance portion of the Farmers in Transition (FIT) Program only until the Canadian Rural Transition Program, announced in the February 26, 1986 federal budget, is in place. Assuming that this federal program provides similar or better services than those provided through Ontario's Re-establishment Assistance Program, the Ontario program should be wound down.

(b) Encourage the federal government to provide a choice of options under its Rural Transition Program.

For farmers of retirement age:

- An interest-free loan secured by a mortgage on a retirement dwelling.

- A six-month allowance.

For other farmers:

- A relocation grant and on-the-job training.

- Living allowance during institutional education.

- Cash transition grant and wage subsidy.

For Implementation in the Medium Term

8. The Province should undertake the following initiatives.

(a) Development of a database on the financial conditions of farmers in Ontario for economic and financial analysis for policy development.

(b) At least six months prior to BFAP's expiry, consideration of a new program to succeed BFAP. The new program should encourage the formation of equity, as opposed to subsidization of debt, and accommodate leases with option to purchase as an option eligible for financial assistance.

(c) At least six months prior to FOCAP's expiry, completion of a program review to determine whether it is meeting the needs of the client group at that time, and whether it should be continued, amended or eliminated.

(d) Completion of a similar review of the Helpline and Farm Family Advisor components of FIT.

(e) Enhancement of extension efforts to encourage share-farming and leasing arrangements for beginning and expanding farmers, including the development of standard forms of leasing contracts.

(f) Assessment of the Trust Companies Act to eliminate the impediments to trust companies entering the farm credit market.

9. Encourage the federal government to undertake the following.

(a) Provide guarantees of private mortgages through the Farm Credit Corporation.

(b) Consider expanding the Farm Credit Corporation mandate to include lending for machinery, equipment and other intermediate-term assets.

(c) Amend the Farm Improvement Loans Act to include guarantees on fixed-rate term loans.

Ideas for Further Study

- The role of part-time and combined-income operators in the farm sector and rural communities.

- The future role of credit unions in the farm credit market.

- Alternative government initiatives to facilitate the introduction of the following debt instruments by commercial lenders and the Farm Credit Corporation:

  - interest rate insurance;
  - accrued interest mortgages;
  - variable amortization mortgages;
  - graduated payment mortgages;
  - split risk mortgages (already taken by FCC).

- Consider eliminating the use of guarantees under the Ontario Young Farmer Credit Program as security for loans for marketing quota.

- The impact of federal and provincial legislation on the security of farm loans (Bank Act, Section 178; Personal Property Security Act).

- The objectives of the Farm Tax Reduction Program and an assessment of its effectiveness in achieving these goals given the large expenditure associated with the program.

- The feasibility of introducing a pension fund and extending unemployment insurance benefits to small business, including farmers.

- The feasibility of a Registered Farm Investment Fund.

- A review of tax legislation as it relates to agriculture.

- The potential for implementation of a joint interest subsidy program by lenders and government.

APPENDICES

APPENDIX A

Summary of Task Force Submissions

The following organizations and individuals submitted briefs to the Task Force.

Canadian Bankers' Association
Christian Farmers Federation of Ontario
Concerned Farm Women
Ontario Federation of Agriculture
Ontario Institute of Agrologists
Prescott Sow-Weaners Association
The Fertilizer Institute of Ontario Inc.
Township of Vespra
Victoria Cattlemen's Association
Women for the Survival of Agriculture
Theresa Armstrong, Bothwell, Ontario
Albert Bouw, Windham Centre, Ontario
Ron Christie et al., Staffa, Ontario
H. Alan L. Emmerson, Woodstock, Ontario
Joe Frisa, Parkhill, Ontario
A. Gardner, Lucknow, Ontario
P. Groot, Fruitland, Ontario
James F. Hay, London, Ontario
Gordon Hill, Varna, Ontario
Corinne King, Toronto, Ontario
Harold Klages, Desboro, Ontario
Lorne and Florence Lambertus, Mildmay, Ontario
Joseph Lubbers, Almonte, Ontario
R. Bruce McCuaig, Martintown, Ontario
George F. Molnar, Harrow, Ontario
Kenneth A. Palen, Centralia, Ontario
Adrian Vos, Blyth, Ontario

In the submissions, a wide variety of issues were raised and solutions suggested. The Task Force has evaluated all proposals for action, of which a summary has been provided in Chapter VII. Extracts of the major points made in the submissions from organizations, and a summary of the submissions presented by individuals are provided in this Appendix.

The Canadian Bankers' Association

Issues:

- Agricultural outlook is for declining prices for grain and livestock resulting in contracting net farm incomes and intensifying financial pressures.
- In addition to low commodity prices, other reasons for farm failures are marginal land use, size of farm debt, poor farming practices, lack of management ability, inadequate financing, etc.
- Declining farm asset values and prospects for lower agricultural commodity prices would suggest that now may not be a good time to enter the industry.
- In the supply-managed sectors, quota values are becoming prohibitive to beginning farmers.
- Lower farm asset values may jeopardize income security for retiring farmers.
- Financial difficulties among the farmers who are traditionally the most innovative, impede the implementation of new technology even where there are apparent long-term benefits.

Suggested solutions:

- Rental and lease of farm assets in lieu of purchase.
- Normal adjustment to economic environment to be allowed to take place.
- Decisions affecting problem accounts should be left to the farmer and the lender(s) involved without interference by government or any other body.
- Increase the competitiveness of the industry by letting the cost of farming come down by way of production research, improved market information, improved record keeping and financial management.
- Assistance programs would be beneficial in solving the social problems associated with the adjustment process such as relocation assistance, retraining programs etc.

Christian Farmers Federation of Ontario

Issues:

- The economic adjustment that agriculture is experiencing, is resulting in 20-25% of producers not being able to maintain both interest and principal payments on their loans.

- Low commodity prices and declining asset values will continue to erode the debt carrying capacity of many farms.

- Too much debt at a time of deflation in agriculture.

- Continuing deterioration of the economic circumstances in agriculture.

- Farm failure rate to stay at an unacceptably high level.

- As most assets of failing farm enterprises are consolidated into existing farms, there will be a loss of diversified ownership.

Suggested solutions:

- In general, a limited role for public policy in order to moderate external impacts, to guarantee a basic return to family farmers on food produced for Canadians and to develop food self-sufficiency for Canada.

- In the long-term, refinancing by way of equity and retained earnings.

- Federal-Provincial debt set-aside program.

- A pool of loanable funds should be created for new and innovative enterpreneurs with rates not in excess of 2% above inflation.

- Farm Credit Corporation to provide long-term financing to all beginning family farmers, up to 75% of productive value of farm assets; rate should not exceed 2% above inflation for first five years after which they should be allowed to adjust to market levels over a five-year period.

- Farm bank feasibility study to be carried out.

- Institution of grass roots-type Farm Credit Association for long term financing of agriculture.

- Extension of BFAP by adding a four-year subsidy phase-out at the end of the present five-year entitlement and to include an option for those who lease farms.

- A program of compassion for the many farm families being forced off their land.

Concerned Farm Women

Issues:

- Product prices that are below cost of production.

- Continually changing economic patterns.

- Survival of the family farm.

Suggested solutions:

- Cost-of-production pricing.

- Moratorium on all farm foreclosures.

- Debt review boards with authority to impose debt restructuring.

- Producer controlled, orderly marketing system.

- Input controls and interprovincial trade regulations.

- Enhanced "Buy Ontario" programs in hospitals, nursing homes, school cafeteria and other institutions funded with public money.

Ontario Federation of Agriculture

Issues:

- Low commodity prices and rising input costs.

- Declining equity positions.

- Effects of recession in agriculture extend to entire rural community.

- Availability and cost of credit.

- Ownership and leasing.

Suggested solutions:

- Legislation to allow more types of financial institutions to enter the farm credit market.
- Government guarantees for private mortgages.
- Mortgage insurance for rural properties, similar to insurance offered on urban properties by CMHC.
- Farmers' bank.
- Removal of unfair differences in regional programs affecting farmers' competitiveness within Canada.
- Trade and tariff protection.
- Stabilization.
- Improved marketing systems and control of product supply.
- An integrated financial assistance package.
- Debt review board with powers.
- Moratorium on OFAAP Option C liquidations.
- Government funding for Farm Financial Advisory Service.
- Job retraining, relocation assistance and career counselling for exiting farmers.
- Allow private mortgages under BFAP.
- Extend benefit period BFAP to 10 years
- Remove discrimination under BFAP against beginning farmers who have rented land.
- Enhance OMAF extension services, strengthening the link between "local" OMAF and local farm groups.

Ontario Institute of Agrologists

The submission of the Ontario Institute of Agrologists was based on a survey of its membership and presents a synopsis of the views of a large number of respondents, rather than a policy statement of the Institute.

Issues:

- Excess supply of farm products.
- Beginning farmers with heavy debt burdens are at a competitive disadvantage compared to established farmers.

- Beginning farmers with heavy debt burdens are at a competitive disadvantage compared to established farmers.

- Honourable exit for retiring farmers for those who have no chance of success.

- Public sector programs are viewed as reacting to situations and crises instead of acting to strengthen the industry.

Suggested solutions:

- Agricultural finance should be directed toward achieving economic stability through measures that lead to more effectively balancing supply and demand at reasonable levels of financial returns.

- To expedite honourable exit from the industry.

- In view of need to limit production, expediting the entry of new farmers is not advantageous.

- Financial assistance should be on a stable, long-term basis; it is more desirable and beneficial to assist existing farmers toward economic stability.

- Land banking to reduce the supply of farm products and to assist existing farmers.

Prescott Sow-Weaners Association

Issues:

- Impossible to sell weaners at profitable prices.

- Loss of Quebec market for weaner pigs.

- Countervail duty on hogs.

- Difficulty getting labour at minimum wage.

- High price of feed in Eastern Ontario.

Suggested solution:

- Close sow-weaner operations by way of a buyout at $2,037.06 compensation per sow.

The Fertilizer Institute of Ontario

Issues:

- Farm commodity prices.

- Trade supplier profit margins too narrow to permit extension of crop financing to farmers.

- Section 30(1) of the Personal Property Security Act now has effectively stopped a source of potential financing from suppliers.

Suggested solution:

- Amendments to the Bank Act and the Personal Property Security Act to allow for improved availability of trade supplier credit to farmers.

Township of Vespra, Ontario

Resolution:

- "Be it resolved that the Council for the Township of Vespra requests that the Minister of Agriculture for the Province of Ontario consider the implementation of a Task Force to investigate the state of the Agriculture Industry in Ontario. Considering the number of farm bankruptcies and lack of any stabilization in the beef and pork industry, it is high time the farmers of this province receive a long overdue hearing which should result in recommendation to improve and stabilize our agriculture industry."

Victoria Cattlemen's Association

Issues:

- Serious depression in agriculture.

- A profitable agriculture industry supports 40% of the whole economy.

- Farmers will use all available technology when it is profitable to do so.

Suggested solutions:

- All farmers are in financial difficulty, receiving zero return on their investment.

- Incentives to farmers wishing to get out of farming.

- Financial assistance programs that are widely available to all farmers.

- A long term plan for agriculture so farmers can decide what direction they can take.

Women for the Survival of Agriculture

Issues:

- Credit for beginning farmers.
- Alternative retirement options for exiting farmers.
- High cost of borrowing leaves no money to change methods or to try anything new.
- Spiralling interest rates.
- Inflated production costs.
- Plummeting land prices.
- New and used machinery and machinery repair parts priced unrealistically high.
- Lenders extended credit based on equity which has since eroded due to cost price squeeze.
- Price setting by big business.

Suggested solutions:

- Fair product pricing with a floor price based on a cost of production formula which includes the labour of men, women and children on farms.
- Interest rates that do not rise over 4% above inflation.
- FCC should be set up to lend money on short-term loans the same as banks do.
- Handbook for retirement planning.
- Moratorium on forced 'voluntary' liquidations and foreclosures.
- Debt review boards.
- Extend BFAP eligibility period to 10 years.
- Extend OFFIRR for five years.
- Extend Agricrew program for a longer period, i.e. until October of each year.
- International trade protection.

Summary of Individual Submissions

Issues:

- The problem for beginning farmers is high debt, compounded by low production as it takes time to build an efficient operation.
- High interest rates causing land values to fall.
- Cost-price squeeze.
- Social programs not suitable to rural residents.
- Difficulty to get jobs for exiting farmers who are over forty years of age.
- Psychological stress caused by financial difficulty.
- Agricultural economics have been seriously distorted by legislated intervention.
- Farm assets, inflated far beyond their productive values.
- When the farm business fails, the house must go, and with it, the people's social involvement in the community.
- Many farmers in financial difficulty have no skills and are too old to retrain.
- Cost of inputs too high because of inefficient distribution channels; agriculture as an industry is paying retail prices for raw materials where other industries pay wholesale.
- Inability of Ontario farmers to compete in the markets against subsidized produce from other countries.
- Legislated increases in input prices such as minimum wage, fuel etc.
- Inability to finance farm development through write off of farm losses against other income.
- Effects of the agricultural recession on rural areas.
- Inequitable and ineffective farm liquidation procedures.
- Traditional ladder of farm worker to farm owner, no longer effective in entering farming.

Suggested solutions:

- Delay principal payments for beginning farmers so they may invest further in their operation.
- Debt set-aside and write-down.
- Provide agricultural exports by way of a two-price system.
- Provincial Farm Credit Corporation.
- Government assistance should concentrate on the social problems associated with financial difficulty, such as helping farm families get out of the industry with dignity.
- The industry will be healthier when assets are more closely correlated to productive values.
- Enhanced regulations to be imposed on the chartered banks and other financial institutions.
- Agricultural Service Corporation to rationalize the distribution of farm inputs and to reduce their cost to farmers.
- Veterinary services insurance.
- Reintroduction of BILD program.
- Agribond program, interest deductible by the borrower, tax-free to the lender.
- Supply management in all industries.
- Income insurance with prices based on production cost; market sharing among provinces based on historical production and, incorporating untradeable quota.

APPENDIX B
Statistical Tables and Charts

Index of Tables

TABLE I
Rate of Inflation, Nominal and Real Interest Rates
1961 to 1985
(percentages)

	Nominal Interest Rate 1)	Change in Consumer Price Index 2)	Real Interest Rate*
1961	5.6	0.9	4.7
1962	5.7	1.2	4.5
1963	5.8	1.7	4.1
1964	5.8	1.8	4.0
1965	5.8	2.4	3.4
1966	6.0	3.7	2.3
1967	5.9	3.6	2.3
1968	6.9	4.0	2.9
1969	8.0	4.6	3.4
1970	8.2	3.3	4.9
1971	6.5	2.9	3.6
1972	6.0	4.7	1.3
1973	7.7	7.7	0.0
1974	10.8	10.9	-0.1
1975	9.4	10.8	-1.4
1976	10.0	7.5	2.5
1977	8.5	7.9	0.6
1978	9.7	8.8	0.9
1979	12.9	9.2	3.7
1980	14.3	10.2	4.1
1981	19.3	12.5	6.8
1982	15.8	10.8	5.0
1983	11.2	5.8	5.4
1984	12.1	4.4	7.7
1985	10.9	4.0	6.9

*"Real rate of interest" is the nominal rate of interest minus the rate of inflation.

Sources: 1) Conference Board of Canada, Ottawa, Ontario

2) Statistics Canada. Consumer Prices and Price Indexes. Catalogue 62-001, Ottawa, Ontario, March 1985.

TABLE II

Current Values of Farm Capital, Credit and Net Income, Ontario

1971 to 1984

	Total Capital ($ million)	Realized Net Farm Income ($ million)	Total Credit Outstanding ($ million)	Capital Turnover Ratio* (%)	Debt-to-Asset Ratio (%)
1971	6,868	317	1,269	21.7	18.4
1972	7,522	413	1,341	18.2	17.8
1973	9,220	628	1,531	14.7	16.6
1974	11,710	758	1,759	15.5	15.0
1975	14,443	728	2,105	19.8	14.6
1976	16,963	689	2,423	24.6	14.3
1977	18,623	576	2,812	32.3	15.1
1978	21,256	715	3,295	29.7	15.5
1979	24,690	777	3,854	31.8	15.6
1980	28,494	674	4,311	42.3	15.1
1981	31,286	882	4,773	35.5	15.3
1982	30,873	796	5,035	38.8	16.3
1983	29,057	939	5,045	30.9	17.4
1984	28,551	1,141	5,225	25.0	18.3

Source: Statistics Canada. Farm Net Income Reference Handbook, Ottawa, Ontario.

* Total Capital/Realized Net Farm Income

TABLE III

Credit Outstanding in Ontario by Source

1971 - 1984

($ million)

	Chartered Banks	Fed. Gov't Agencies	Prov. Gov't. Agencies	Credit Union	Ins. Trust & Loan Companies	Private Ind. & Others	Total
1971	458.0	273.3	117.4	7.3	17.2	396.3	1269.4
1972	505.0	283.9	114.0	9.3	21.4	407.2	1340.9
1973	630.0	328.2	111.8	12.0	23.5	425.7	1531.3
1974	689.0	423.7	111.6	14.7	21.4	498.8	1759.2
1975	790.0	521.7	118.9	17.1	19.8	637.5	2105.0
1976	963.0	595.5	123.9	20.2	19.2	701.2	2423.0
1977	1177.0	678.8	131.7	23.6	19.2	781.4	2811.6
1978	1527.0	771.5	136.5	32.0	26.5	801.5	3295.1
1979	1932.0	867.6	152.4	25.5	29.6	846.9	3854.0
1980	2274.0	943.4	163.1	23.3	30.1	876.8	4310.8
1981	2350.0	1040.7	173.7	19.3	52.0	1137.6	4773.3
1982	2370.0	1143.0	184.6	18.9	47.6	1270.9	5035.0
1983	2292.0	1294.5	185.3	27.3	30.3	1215.2	5044.6
1984	2473.0	1309.7	186.0	33.7	27.2	1195.2	5224.8

Source: Statistics Canada. Farm Net Income Reference Handbook, Ottawa, Ontario.

TABLE IV

Proportion of Farm Credit Outstanding by Term in Ontario

1973 to 1984

(percentages)

	Short Term	Intermediate Term	Long Term
1973	30.8	32.8	36.4
1974	30.2	34.1	35.7
1975	32.5	33.5	34.0
1976	35.5	32.2	32.3
1977	34.7	36.6	28.7
1978	37.7	34.8	27.5
1979	48.1	30.1	21.8
1980	47.7	29.9	22.4
1981	48.6	29.3	22.1
1982	49.1	29.4	21.5
1983	52.6	26.4	21.0
1984	52.7	26.6	20.7

Source: Agriculture Canada. Market Commentary, various issues, 1977-1985, Ottawa, Ontario.

TABLE V

Average Capital Value per Farm in Ontario

Selected Census Years, 1951 to 1981

(dollars)

Year	Total Capital Per Farm	Land & Buildings	Implements & Machinery	Livestock & Poultry	No. of Farms
1951	16,988	9,467	2,970	4,550	149,920
1961	30,868	21,200	4,774	4,893	121,333
1971	72,509	54,722	9,396	8,390	94,722
1976	191,026	155,655	21,849	13,522	88,801
1981	379,462	306,845	41,992	30,625	82,448

Sources: Statistics Canada. 1981 Census of Agriculture, Catalogue 96907, Ottawa, Ontario, 1984.

Statistics Canada. Farm Net Income Reference Handbook, Statistics Canada, Ottawa, Ontario.

TABLE VI

Aggregate Current Value of Farm Capital on Farms in Ontario, 1971 to 1984

	Land and Buildings	Implements and Machinery	Livestock and Poultry	Total
		($ million)		
1971	5,183.4	890.0	794.7	6,868.2
1972	5,589.8	961.4	970.4	7,521.7
1973	6,934.1	1,066.5	1,219.4	9,211.0
1974	9,131.0	1,315.6	1,263.3	11,709.9
1975	11,662.4	1,672.1	1,108.3	14,442.8
1976	13,822.3	1,940.2	1,200.8	16,963.3
1977	15,293.7	2,097.9	1,231.9	18,623.5
1978	17,362.4	2,330.1	1,563.7	21,256.2
1979	19,708.3	2,683.7	2,298.4	24,690.4
1980	22,977.5	3,103.8	2,413.1	28,494.4
1981	25,298.8	3,462.1	2,524.9	31,285.9
1982	24,792.8	3,633.7	2,446.8	30,873.3
1983	23,057.3	3,760.9	2,238.9	29,057.1
1984	22,596.2	3,726.1	2,228.4	28,550.7

Source: Statistics Canada. Farm Net Income Reference Handbook, Ottawa, Ontario.

TABLE VII

Ontario Farm Incomes and Expenses

1975 to 1984

($ thousand)

	Average 1975-79	1980	1981	1982	1983	1984
Realized Gross Income	3,211.1	4,462.5	5,043.3	5,011.3	5,095.7	5,407.1
Interest on Indebtedness	233.0	473.0	690.0	600.5	485.4	502.0
Other Operating Expenses	1,883.6	2,741.9	2,839.5	2,972.1	3,016.5	3,137.6
Depreciation	397.5	573.5	631.6	642.9	639.1	626.4
Total Operating Expenses	2,514.1	3,788.7	4,161.0	4,215.5	4,156.2	4,266.0
Realized Net Income	697.0	673.8	882.3	795.7	939.4	1,141.1
Interest Charges as a % of Realized Gross Income	7.3	10.6	13.7	12.0	9.5	9.3
Realized Net Income before Interest Charges	930.0	1,146.8	1,572.3	1,396.2	1,424.8	1,643.1
Interest Charges as a % of Net Income	25.1	41.2	43.9	43.0	34.1	30.6

Source: Statistics Canada. Farm Net Income Reference Handbook, Ottawa, Ontario.

TABLE VIII

Gross and Net Income to Debt Ratios, Ontario

1971 to 1984

	Realized Gross Income ($ million)	Realized Net Income ($million)	Farm Debt ($million)	Gross Income: Farm Debt Ratio (%)	Net Income: Farm Debt Ratio (%)
1971	1,466.2	317	1,269	116	25
1972	1,678.3	413	1,341	125	31
1973	2,123.0	682	1,531	139	41
1974	2,517.6	758	1,759	143	43
1975	2,732.3	728	2,105	130	35
1976	2,836.3	689	2,423	117	28
1977	2,911.0	576	2,812	103	10
1978	3,483.7	715	3,295	106	22
1979	4,092.1	777	3,854	106	20
1980	4,462.5	674	4,311	104	16
1981	4,043.3	901	4,773	106	19
1982	5,011.3	821	5,035	100	16
1983	5,095.7	939	5,044	101	19
1984	5,407.1	1,141	5,225	103	22

Source: Statistics Canada. Farm Net Income Reference Handbook, Ottawa, Ontario.

TRENDS IN FINANCIAL FARM DATA

Chart 1

FARM INPUT PRICE INDEX
1970 - 1985

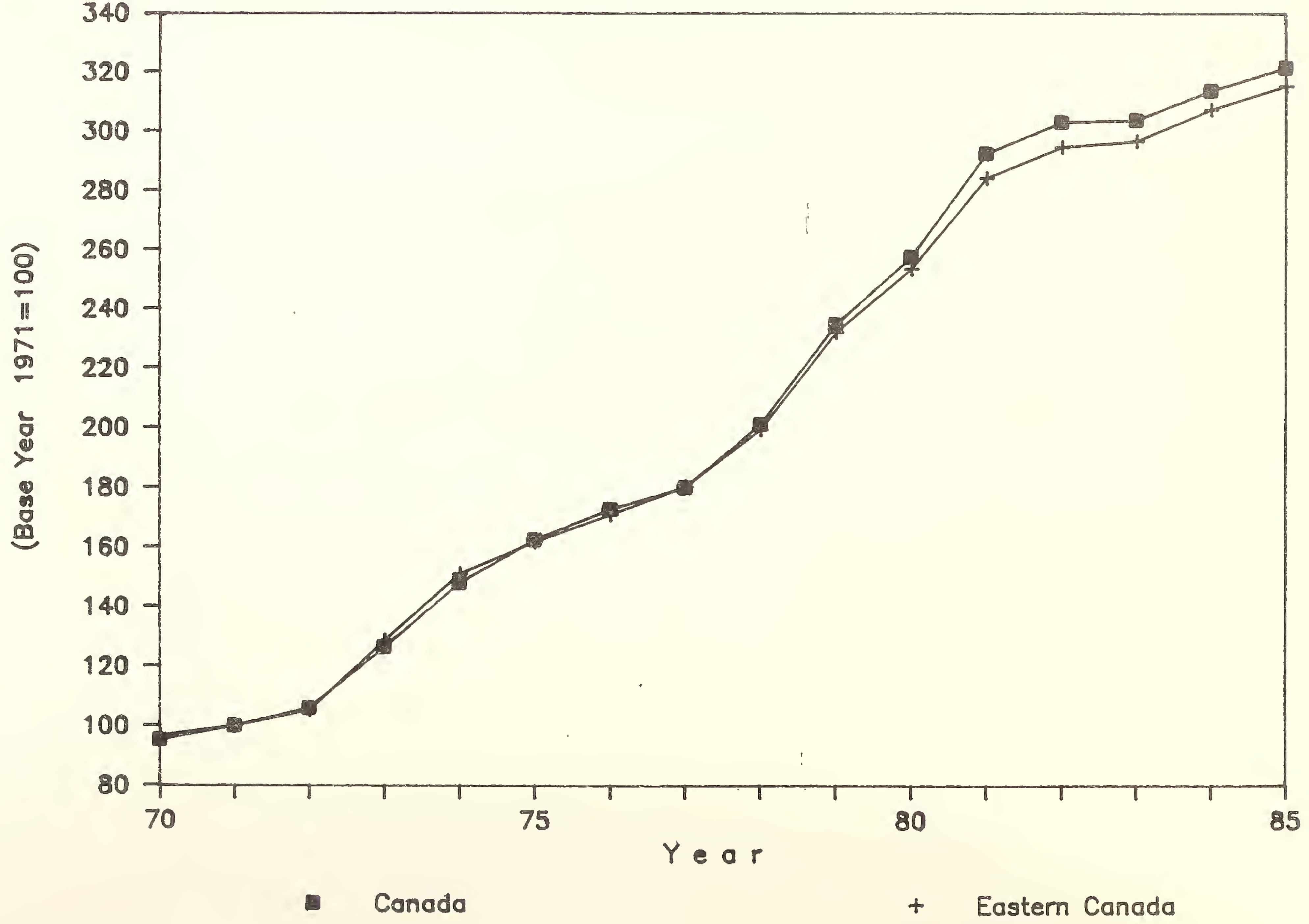


Chart2

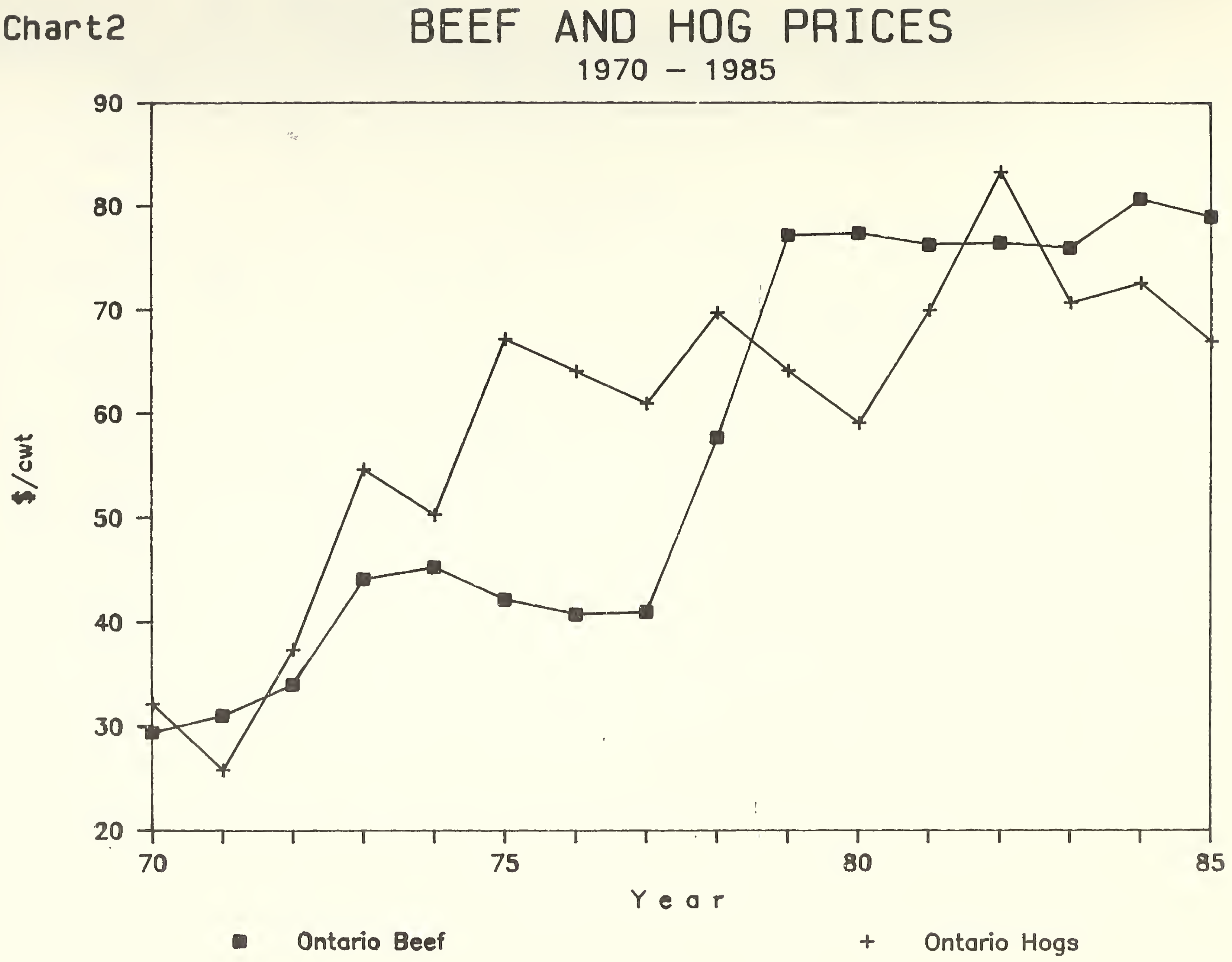

BEEF AND HOG PRICES
1970 - 1985
$/cwt
90
80
70
60
50
40
30
20
70
75
80
85
Year
Ontario Beef
Ontario Hogs

Chart 3 SOYBEAN AND GRAIN CORN PRICES

1970 - 1985

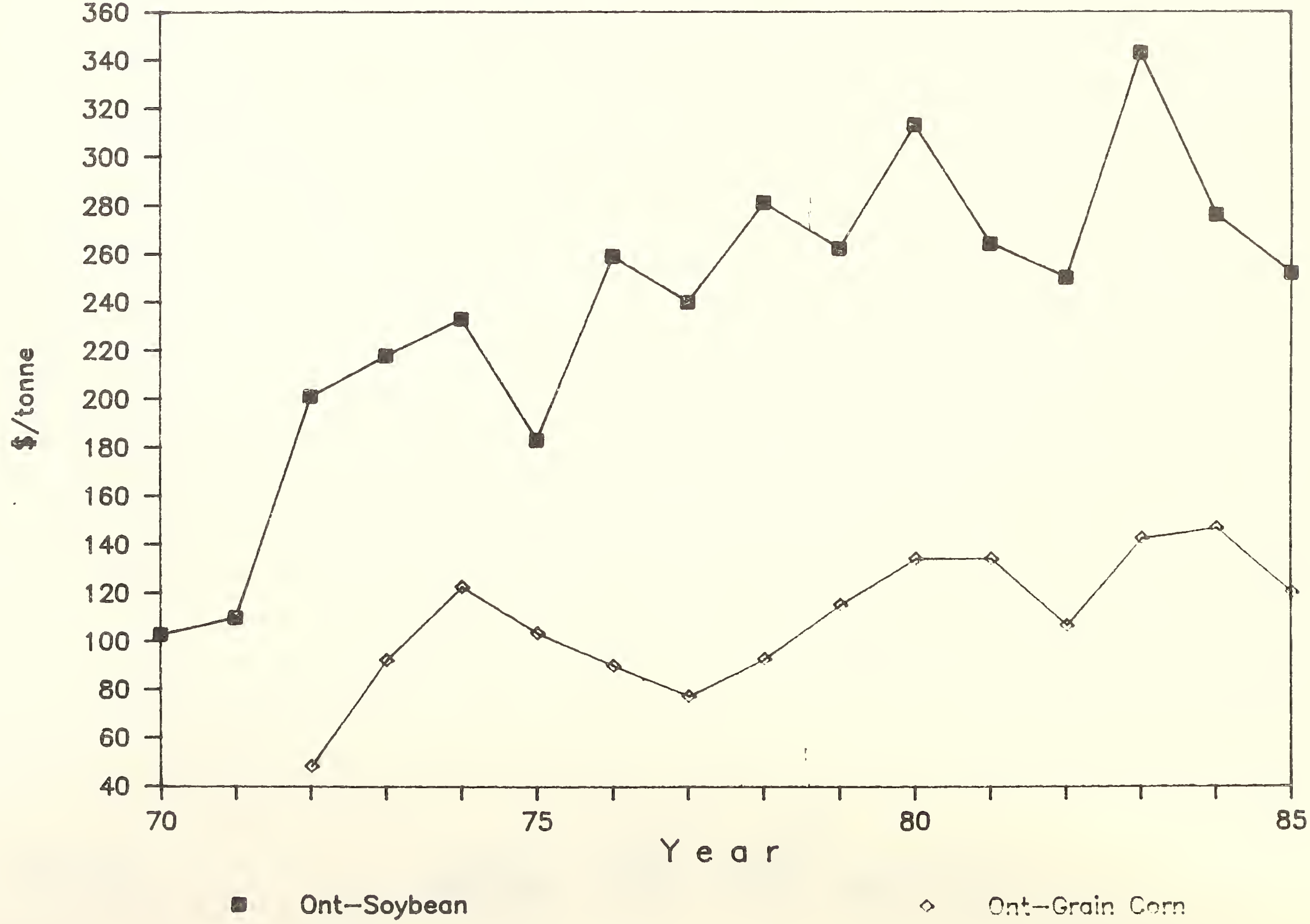


Chart 4

CHICKEN AND EGG PRICES

1970 – 1985

Chart 5

ONTARIO MILK PRICES

1975–1985

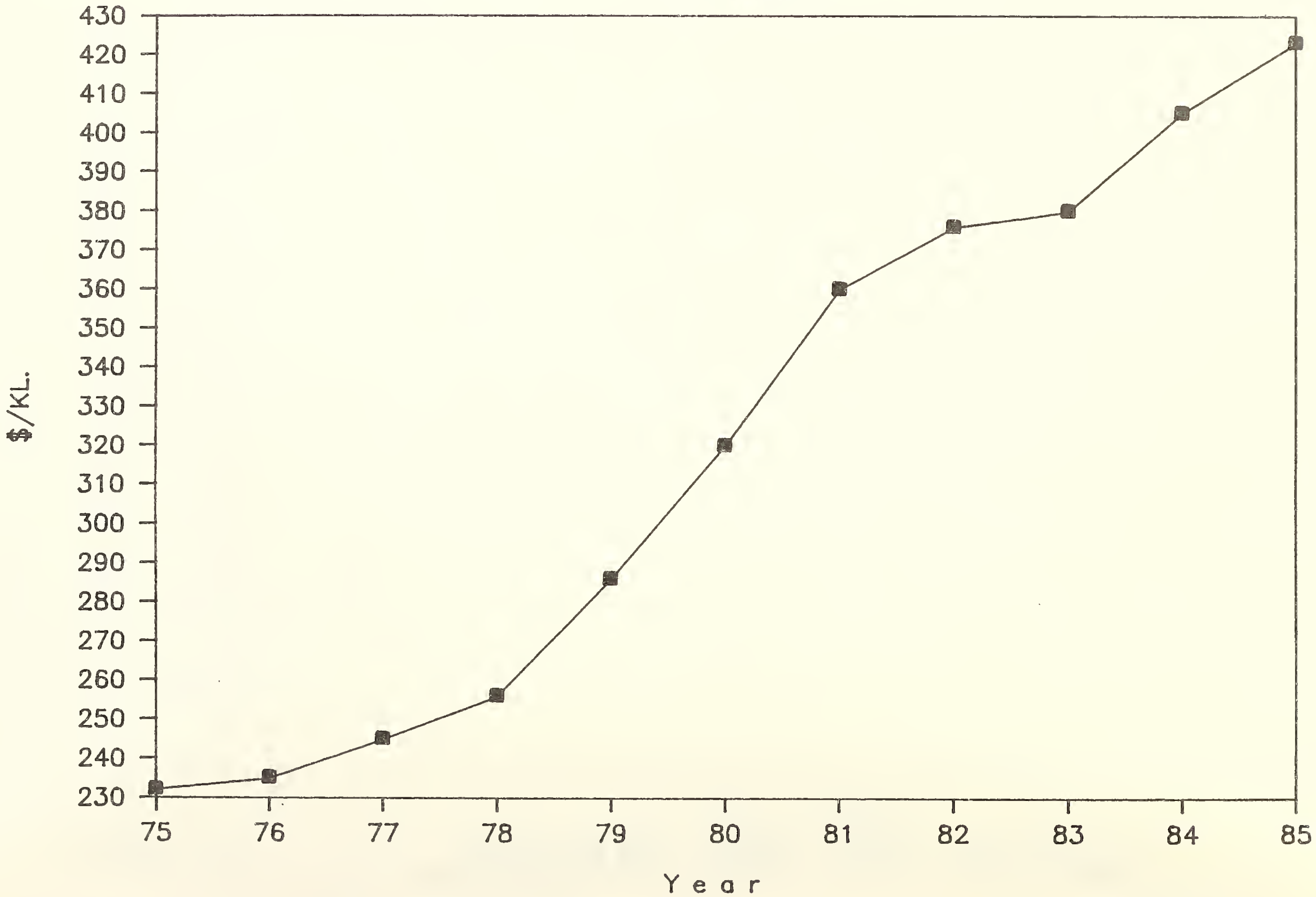
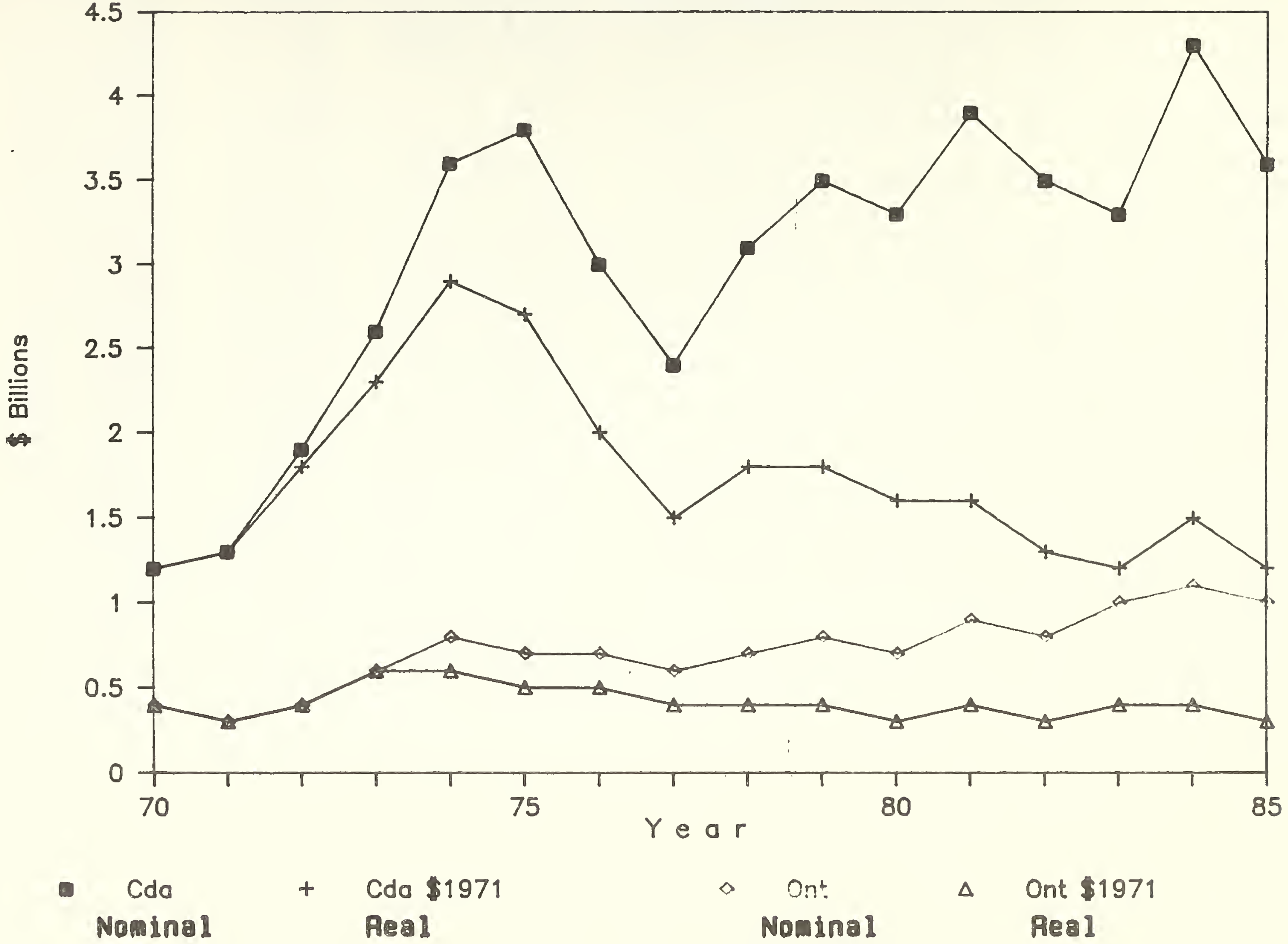


Chart 6

REALIZED NET FARM INCOME

1970 – 1985



APPENDIX C

The Application of New Technology in Agriculture

Introduction

The application of modern technology has had a profound impact on Ontario's agriculture industry, particularly in the last quarter-century.

The average farm size increased from 126 acres in 1951 to 181 acres in 1981 and farm output tripled. During the same period, the total farm population declined from 702,800 to 279,800. The productivity gains made by agriculture during this period were much greater than gains in other industries. This was facilitated by a tremendous increase in the use of inorganic fertilizers, synthetic pesticides, hybrid seeds and advanced mechanization, all of which resulted in improved livestock production and substantial increases in crop yields. New crops such as corn and soybeans, were produced on commercial farms, which in turn revolutionized livestock production. Technological advances were enhanced by market forces which, until the early 1970's, resulted in steadily diminishing real costs for fertilizer, fuel and other oil-based products. In addition, the demand for North American farm products was strong and the farm sector stressed efficiency and the short-term maximization of production. The tremendous success of the industry came about because farmers continuously modified technology to adjust to the changing economic environment. At the same time, new technologies resulted in significant changes in the environment and the social fabric of rural Ontario; some changes were perceived to be detrimental.

Since the late 1970's, economic trends have shifted completely, and a new approach to farm production is required. The real cost of inputs has increased and real prices received for most commodities have declined. For most farmers, this has meant reduced net incomes and a need for new production patterns. The mandate of the Task Force includes the investigation of technology transfer and adoption, and the impact of current financial conditions on the industry's ability to implement technological adjustments.

Three major areas are examined: technology development, technology transfer and technology implementation. The implementation of technology is of particular interest to the Task Force because it involves financing new technologies in commercial operations.

Technology Development

A major objective of agricultural policy is to facilitate the adjustment of farming patterns to new economic conditions. The industry must continuously assess whether its products meet market requirements and whether its resource endowment is optimally utilized.

Traditionally, technology development has been conducted and financed by governments through universities and colleges, and their own laboratories and experimental stations. Farm supply companies have also been active in developing new farm technologies. Farmers, as primary producers, have not played an active role in the direct financing and control of technological development (an exception is engineering; many mechanical and building developments have been conceived and financed by farmers). This contrasts with most other primary industries, such as forestry, mining and oil, where much applied research is conducted in-house. Consequently, technology development in agriculture is not so much driven by demand, as pushed by the suppliers who hope to profit by promoting the technology or equipment they are selling.

A mechanism is needed to enable farmers, as primary producers, to influence agriculture research and development to best benefit the farm sector. Because farmers do not now have the financial means or corporate scope to take over much of the technological research, such a mechanism must be based on forces that ensure development of farming technology becomes more demand driven. Perhaps the best way of achieving this goal is to promote increased farmer involvement in government research planning to ensure that new products and technologies are developed in response to farmers' needs. Participation by other groups (e.g. consumers, environmentalists, and food processing industry representatives) would help to ensure that farmers' technological requirements would be satisfied in ways that are compatible with other public interests.

Technology Transfer - Extension and Education

Technology is not simply equipment and implements; it also involves the skills and knowledge of people who develop and use productive and profitable farming methods. Uptake of available technology is as important as technology development.

The application and improvement of technology is an investment issue. That means farmers must perceive both an economic incentive and an opportunity for investment. From a public point of view, the farming sector's overall investment rate is an important indicator of the long-term potential of the industry and of its competitiveness. But to take advantage of investment opportunities, Ontario farmers must be aware of innovations that can help their farming methods and objectives. They must be familiar with sources of information they can use to improve their operations. This relates to the choice of products, methods of production and the financing.

Technology Implementation and Financing

The mandate of the Task Force specifically included examining the transfer and adoption of new technology as it relates to current patterns of financing and the financial conditions of farmers in Ontario. However, the implementation of new technology and the associated risks and financing costs are strictly the responsibility of the individual farmer.

During the 1970's, the outlook for agriculture was generally positive and the industry was characterized by rapid technological change. The downturn in the world economy and the reversal in the outlook for agriculture have since led to a financial situation which dictates technological adaptation for even greater cost competitiveness. However, farmers who suffer from financial limitations caused by depressed commodity markets and high debt loads, can least afford to take advantage of new technology.

Conclusions

The Government of Ontario is already involved in two of the three facets of the technology investment decision. It supports research and development of new products and agronomic practices and is the major financial sponsor of agricultural education.

The need for government involvement in other aspects of research and development, as well as the adoption, transfer and implementation of new technology, will remain high and should be a dominant part of government policy on agriculture.

The adoption of new technology is an investment decision that must be made by individual farmers and based on sound business principles. The government must play a significant role in this process, but at the same time be aware of the risk of inducing investments that are contrary to the direction the market would otherwise dictate.

Government efforts should be concentrated in areas where individual farmers are unwilling or unable to make investments because of a lack of resources and/or the inability to assume risk. In these areas, government must ensure that efforts are directed at what the agricultural industry perceives as market needs.

Government may also have some role in providing financial assistance to individuals for the adoption of new technology that benefits society as a whole, as well as the farmer. Examples include pollution control or land conservation techniques, where farmers are investing in technology that is of little immediate or direct benefit to them, but is necessary for environmental or other reasons.

APPENDIX D

The Impact of Supply Management and Quota Values on Farm Financing

Introduction

Between 30% and 35% of gross farm revenues in Ontario are generated by regulated commodities. These include milk, tobacco, eggs, chicken and turkey, which together generated $1.8 billion out of a total of $5.2 billion in total farm cash receipts in Ontario in 1984. From a financing point of view, the effects of supply management and associated quota show up on the balance sheet and income statement of the farmer.

While the Task Force has not attempted to evaluate the full social and economic costs and benefits associated with supply management and quota, some discussion of the major characteristics of this system is the associated financial requirements for farmers.

The main benefits of supply management are:

- increased bargaining power of producers;
- the power to set product prices incorporating cost-of-production formulas; and
- the guarantee of a market for all producers who produce within their quota.

The costs of supply management stem from:

- production restrictions that have been enforced by marketing boards and which have resulted in unused production capacity;
- import and interprovincial trade controls;
- higher food costs to consumers;
- administrative expenses of maintaining and operating the system; and
- the costs of ownership of quota rights.

In some sectors, additional costs have been caused by volume restrictions on the ownership of quota rights, limits on quota transfers and administrative rigidities associated with the attachment of quota rights to physical production facilities.

Supply management has allowed commodity prices to be set above market clearing levels because of limited competition and restrictions on lower-cost imports. Thus, supply management has partially insulated farm incomes from fluctuations in world commodity markets and enhanced income stability.

Quota Values

The supply management system has yielded benefits to quota holders, which are reflected in the values of quota rights or real estate attached quota rights. Quota values are the result of price setting above market clearing levels. If quota are attached to real estate, as in the feather industry, the real estate will increase in value beyond its replacement cost. The difference between its value and the replacement cost represents the value of the right to market from the premises.

When quota are transferred, the capitalized future benefits go to the seller who thus removes these benefits from agriculture. At the same time the cost of quota rights cancels most of the benefits of the supply management system to the new owner who must allocate a significant part of his/her investment to their purchase.

Financing Requirements

The major effect of supply management on the balance sheet of participating farmers has been the whole or partial capitalization of associated income benefits into quota values or into the values of assets to which quota are attached. The effects on the income statement surface in improved level and stability of gross farm income on the income side and the carrying charges of quota holding rights on the cost side.

Quota are not always freely transferable, and therefore cannot be easily assigned a market value. For example, marketing rights for chicken and eggs are "attached" to physical facilities. However, the Task Force has determined current values of quota rights in each sector (see Table D-I). Quota represent significant asset values for participating farmers, varying from an average investment by each dairy farmer of more than $165,000 to more than $700,000 in average investment by each turkey farmer. Additionally, there appears to be a positive correlation between quota values and the degree of concentration in each sector. Dairy is the least concentrated, followed by tobacco, while the poultry industries are the most concentrated. High quota costs represent a significant demand on farm capital and farm financing. The Task Force estimates that quota values represent from 30% to 70% of total farm capital, depending on the commodity.

Because quota values have fluctuated widely in past years, there is substantial risk involved when purchasing quota, especially when credit is employed. As a result, lenders demand repayment of loans for quota rights with terms normally not exceeding five years and well within the expected life of the quota right. This contrasts sharply with the customary practice of matching the repayment term of loans with the expected life of the asset being financed.

The financial requirements associated with quota rights may be expressed in terms of opportunity cost and investment recovery. The Task Force has estimated the impact of quota rights on cash flow, assuming that the capital tied up in quota would yield a rate of 10% when invested in government bonds or term deposits and the investment recovery rate is five years. (see Table D-II). Accordingly, in 1984, the capital cost and repayment of quota rights for newly purchased quota for beginning farmers represented between 33% and 63% of farm revenues, depending on the commodity.

For existing farmers, repayment and opportunity cost may be perceived as hypothetical; for the beginning farmer they are real. Beginning farmers need higher product prices to justify the investment in quota. Conversely, if there were no requirement to buy quota rights, total capital requirements would be reduced accordingly and lower product prices would achieve the same return on investment as when quota rights and higher prices are involved.

While product prices may be perceived as high enough to justify such investments for existing farmers, the associated financing costs for new farmers are high and are thought to be the cause of a significant portion of the debt problem. Tying up farm capital in quota also prevents investments in other assets, reducing opportunities for diversification and risk reduction.

TABLE D-I

Estimated Quota Volumes, Values and Investment by Commodity, Ontario 1984

Commodity	Units	Industry Quota Volume	Value Per Quota Unit ($)	Number of Quota Holders	Average Quota Per Quota Holder	Investment Industry Total ($ thousand)
Milk Fluid	thousand litres	3,455	245.00	10,826*	165	1,785,000
Milk Industrial	million litres	1,286	0.73			
Chicken	1,000**	20,062	15.00	695	433	301,000
Eggs	1,000 layers***	7,438	35.00	768	339	260,000
Turkey	pounds	168,480	0.70	162	728	118,000
Tobacco	pounds	384,077	2.00	2,567	299	768,000

* Fluid and industrial quota were consolidated

** 1 unit = 9.5 kilograms (average 1984 allotment for broilers and roasters)

Source: Ontario Ministry of Agriculture and Food, Economics and Policy Co-ordination Branch

TABLE D-II

Average Farm Investment Requirements Associated with Quota Holdings, Ontario, 1984

Commodity	Farm Quota Investment	Annual Quota Financing Requirement Per Farm	Total Value Farm Production Per Farm	Quota Financing Requirement as % of Total Cash Receipts
		($ thousands)		
Milk	165	41	84	52
Chicken	433	114	345	33
Eggs	339	89	264	34
Turkey	728	195	480	41
Tobacco	299	79	125	63

* Amortized in equal blended amounts to recover investment in five years at an annual investment rate of 10%.

APPENDIX E

Statement on Debt Review Boards by the Honourable Jack Riddell, Ontario Minister of Agriculture and Food, to Ministers of Agriculture Conference

I would like to introduce for discussion the subject of Debt Review Boards.

In one of the papers tabled at the Conference by my Ministry, The Farm Finance Dilemma, 1985 and Beyond, we indicated that the financial situation of Canadian farmers has deteriorated since the early 1980's. We estimate that approximately 5% of all farmers are in serious financial difficulty and that approximately 25% are experiencing increasing financial problems. In light of these circumstances, we want to vigorously pursue long-term solutions in co-operation with the federal government.

One area in which I believe the federal government must take leadership because of its legislative mandate is Debt Review Boards.

I recognize that there is considerable debate on the topic of third party review agencies with powers to impose their decisions, particularly where such decisions involve debt concessions.

Those in favour of Debt Review Boards argue that a failure to provide a review forum would result in the loss of some excellent farmers who, through bad luck rather than bad management or undue risk-taking, find themselves unable to meet their obligations.

Supporters of the concept of Debt Review Boards also believe that farmers in financial difficulty need to have an avenue open to them to offset the unilateral power held by creditors, particularly the chartered banks.

Concessions by lenders are being undertaken in the normal course of business. However, the availability of such concessions varies from lender to lender and from region to region and does not necessarily relate to the quality of the farmer. An agency with the power to impose debt concessions would institutionalize the debt adjustment process. This would provide equitable treatment in all regions by all lenders.

On the other hand, acceptance of the concept of an agency with debt adjustment powers is far from unanimous. Those opposed to the concept make a number of compelling arguments.

First, it is very unlikely that an operation is viable at zero equity. Therefore, writing down or setting aside debts to security value would not be sufficient to make an operation successful. Equity would have to be created. Is it reasonable to ask secured creditors to take any less than the value of security since they do have shareholders, or, in the case of public lenders, the taxpayer? Further, should equity be created for someone who has got himself or herself in a position where obligations cannot be met?

Second, if debt is written down or set aside to a level where the farmer can make the operation viable, the poorer the manager, the larger the write-down or set-aside would have to be. This could inhibit the maintenance of a healthy, competitive industry.

Even if a zero-equity situation would be viable, there are arguments against debts being written down or set aside.

Take the following example: Two farmers have similar properties. One is frugal, manages well and meets his/her obligations. The other is a spendthrift, manages badly and has built up arrears. Land values fall and the security value of the properties fall to about the debt level of the first farmer. If debts are written down to security level, both farmers are left in the same position and assets remain in the hands of the poor manager. If debts are not written down, the frugal farmer, although equity has been lost, at least has the comfort that he/she gets to remain on the farm, while the farmer who did not manage well is put off, making way for someone who can manage better.

Third, unless the debt adjustment package also includes some provision to provide new operating credit for the farmer whose debts have been restructured, an ongoing operation would be difficult.

Fourth, any interference in the operation of banks' lending and recovery procedures may result in unwillingness to lend to those who are in an even slightly risky position. This could be the farmers who need a loan the most. This may result in the need for an increased public sector presence in the high-risk loan area.

Finally, the removal of the most drastic impacts of risk-taking would tend to encourage greater economic risk-taking in the future.

In Ontario, we are doing what we can within our legislative authority to provide farmers with financial management advice and training as well as an objective appeal process for our existing credit programs. With our Farm Operating Credit Assistance Program, all farmers have the right to have their situation reviewed by the Provincial Decision Committee. Where our Committee feels that a farm operation is viable, we provide interest assistance and loan guarantees and encourage the lender to provide Small Business Bonds, to reschedule debt payments, etc. In cases where the lender does not agree with our decision, we discuss the matter further, with the goal of trying to change the lender's view. However, we have no authority to impose our decisions on the lenders.

Clearly given all of these issues, the subject of Debt Review Boards is a complex one which our farmers want to know more about and which requires our full attention and discussion.

APPENDIX F

Capitalization of Government Program Benefits

Introduction

Government support for agriculture is widespread. It takes many forms but direct financial transfers through stabilization payments or credit subsidies are the most common. Governments also support agriculture through research, market development and the taxation system. Moreover, through enabling legislation, governments have allowed production of certain commodities to be restricted through supply-management quota. Quota and financial transfers have an immediate impact on yearly farm incomes, while other types of assistance have longer-term economic effects.

In 1985, net farm income in Ontario was $940 million. Governments account for a significant proportion of net farm income. The Ontario government alone provided $261 million in transfers to farmers. These benefits not only have an impact on farm income, they alter farmers' business decisions. For example, credit subsidies may encourage a farmer to maintain a higher level of debt while market stabilization may cause a farmer to increase production.

In addition to affecting income and production, the benefits of government programs have affected farm asset and equity values through capitalization.

Effects of Capitalization

Farm capitalization refers to the increase in value of an income-earning asset, reflecting increases in the future stream of net earnings of that asset beyond what its value would be without government involvement. Effects of capitalization of government transfer payments to agriculture include:

1. Increased asset prices benefit program recipients but are translated into higher costs for second generation entrants into the farming industry. Accordingly, the effectiveness of program benefits tend to diminish over time. Land and quota are the most commonly thought of capitalized assets in farming. However, benefits may also accrue to other input factors such as variable costs or return to labour and management. Higher production costs may result in reduced competitiveness in world markets.

2. Higher debt levels may be related to the availability of government assistance programs. Increased debt may occur for several reasons including:

    - willingness of lending institutions to make farm loans;

- availability of government financial programs that could encourage farmers to borrow more than they otherwise would; and

- higher farm start-up costs that necessitate increasing debt.

3. Expectations of a financial safety net have been caused by a tradition of long-term and ad hoc government assistance to the farm sector.

   Farmers have, therefore, not had to fully account for market and other risk factors in their decision-making. Accordingly, asset prices are higher than would be the case without government assistance because they have not been discounted by true risk factors.

A Review of Two U.S. Studies

In 1984, a study from Texas A & M University[1] estimated the impact of government farm credit programs on farmland. The authors examined how government farm credit programs have influenced farmland values, farm indebtedness, and the percentage of farmland owned by farmers.

The results suggested that a one-percentage-point subsidy on farm debt yields a long-term (10 to 15 year period) increase in farmland prices of slightly over 2%. A five-percentage-point subsidy generates 6.5% higher farmland prices. Since U.S. farmland is valued at about $800 billion, a 2% increase would equal $16 billion, and a 6.5% increase would equal $52 billion in wealth transferred to farmers through government farm credit programs.

In the short run, the removal of a one-percentage-point subsidy decreased farm debt by 0.5% in the first year and a five-percentage-point subsidy decreased first-year debt by 2.3%. The effects are more significant in the long run. The removal of a one- and five-percentage-point subsidy decreased debt by 1.5% and 4.7% respectively.

It is clear from these statistics that without government credit subsidies from 1976 to 1980, farmers' assets would have been smaller, but debt would have been lower.

The impact of government farm credit programs on the percentage of farmland owned by farmers was estimated to be extremely slight.

The Economic Research Service of the U.S. Department of Agriculture conducted a study of "capitalization of farm program benefits in 1972.[2]

1 Hughes, Dean W.; Pension, John B.; and Bednarz, Curtis R. Subsidized Credit and the Farm Land Market, Texas A & M University, December, 1984.

2 United States Department of Agriculture. Capitalization of Farm Program Benefits into Land Values", Washington, D.C., October, 1972.

The authors concluded that, depending on the region and commodity, the rate of capitalization of government program benefits ranged from 12% for rice and peanuts to 21% for cotton, with only a portion going to land values (one-third in the case of cotton).

It is determined that government programs increased the income available to farmers, but the impact of these benefits on land values was less than originally thought. Eliminating government assistance would reduce farm income by $1.59 billion to $9.4 billion in the first year (based on 1970 income figures), but would reduce land values by less than 2%.

Certainty of long-term program benefits is likely to result in greater capitalization because future income is also more certain. If this is the case, all benefits are not necessarily lost to the next generation, although entry costs would be higher because of the increased values of assets.

The Impact of Subsidies in Ontario

An Ontario study[3] shows program benefits which are most prone to capitalization are those which are:

- viewed as permanent and ongoing;
- rich; and
- targeted by commodity, factor of production or region.

Examples of such programs available to Ontario farmers include the:

- Ontario Farm Tax Reduction Program;
- Ontario Farm Adjustment Assistance Program;
- Beginning Farmer Assistance Program;
- Tile Drainage Loan Program;
- Ontario Farm Income Stabilization Program;
- Federal Dairy Subsidy;
- Federal Agricultural Stabilization Program.

Policy Implications

Government assistance to the farm sector should attempt to enhance the economic viability of the industry, while minimizing the negative impacts of capitalization of benefits into farm asset values.

3 Ontario Ministry of Agriculture and Food. Capitalization: A Problem of Government Assistance Programs, July 2, 1983.

Assistance programs should aim to improve the overall performance and competitiveness of the agriculture system without distorting prices, influencing producer decisions and fostering the unproductive capitalization of government program benefits.

One-time benefits are not likely to be capitalized because they are not anticipated. However, the effectiveness of such programs in enhancing the competitiveness and stability of the sector may be questionable because they do not affect production or marketing decisions.

When direct assistance programs (which could be capitalized into asset values) are necessary, risk of benefit capitalization can be reduced if they are made available to selected groups, and if they have a stipulated expiry date.